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SRI—Shibboleth or Canard (Socially Responsible Investing, that is)

Joel C. Dobris¹

“The business of business is business.”²

The financial innovation and prosperity of recent years, among other things, has rewritten the SRI script. Conduct is changing and the scene is set for a change in the law. In this essay the author engages this new and intriguing world of investing from a trust law viewpoint.

This is a set of personal thoughts about Socially Responsible Investing, or SRI, begun in May of 2007. I might also have subtitled it Slouching Towards Bethlehem.³ Take them or leave them as you will.

¹ Copyright © Joel C. Dobris (2007). Professor of Law, School of Law, University of California, Davis. No one is responsible for the thoughts expressed here (especially the people with whom I have been privileged to meet and the entities with which I have been associated), except for me. I got help I didn't deserve from Jack Ayer, Carolyn Clark, Holly Doremus, Chris Elmendorf, Katherine Florey, Jim Garland, John Hunt, Nancy Jacobs, Paul Jacobs, Tom Joo, David Levine, Al Lin, Rob Sitkoff and Dick Wydick. I got good research assistance from Nicholas Godlove, James Hazlehurst and James Yi and financial support from Deans Rex Perschbacher and Kevin Johnson of the UC Davis School of Law. Some of these ideas emerged in my preparing for a mini-conference sponsored by the National Center on Philanthropy and the Law, NYU School of Law and The Investment Fund for Foundations (TIFF). I learned a lot from the participants at that conference. Anything good here I likely unintentionally stole from them and anything bad surely came from me. As always, I've learned a lot from Harvey Dale, Jim Garland, John Langbein, David Levine and Bevis Longstreth.

² Alfred T. Sloan, Jr. http://en.wikipedia.org/wiki/Alfred_P._Sloan, though often attributed to Milton Friedman. University of Sydney graduation address by Frederick Rawdon Dalrymple AO, <http://www.usyd.edu.au/senate/gradsDalrymple.shtml>. If you prefer, Calvin Coolidge said, “The business of the American People is Business.” http://www.calvin-coolidge.org/html/the_presidency_in_the_popular_.html.

³ William Butler Yeats wrote a poem of that title -- Slouching Towards Bethlehem (“... what rough beast, its hour come round at last, slouches towards Bethlehem to be born?”). William Butler Yeats, The Second Coming, in The Yeats Reader: A Portable Compendium of Poetry, Drama, and Prose 68, 69 (line 22) (Richard J. Finneran ed., 1997). Or, if you prefer Joan Didion wrote a book of that title -- Slouching Towards Bethlehem: Essays (1968).

SRI is what you make of it, though it can be defined. Let's say it's "managing money according to ethical criteria"⁴ just to have a definition. Or, if you want,⁵ "doing well while doing good."

Why do people do SRI?

As a friend put it to me, they do it:

(1) TO FEEL GOOD. This includes boasting rights and sleep-at-night rights.

(2) TO MATCH THE MISSION. The UN doesn't invest in arms makers.

(3) FOR BETTER RETURNS. The thought is that clean, caring corporations, those that are "best in class," will have brighter futures than dirty, non-caring corporations.⁶

(4) TO CHANGE CORPORATE BEHAVIOR.⁷

(5) TO INFLUENCE SOCIAL POLICY OF CORPORATIONS AND GOVERNMENTS.⁸

⁴ Michael S. Knoll, Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment, 57 Bus. Law. 681 (2002). SRI is also called Ethical Investing and ESG investing (Environmental, Social and Governance). See Caggemini & Merrill Lynch, World Wealth Report 2007. SRI is to be distinguished from CSR – corporate social responsibility. See N. Craig Smith & Halina Ward, Corporate Social Responsibility At a Crossroads?, 18 Business Strategy Review 1 (2007) (Summary and analysis of current thinking about CSR in Britain via interviews with business insiders which inter alia suggest the term CSR may be too vague to be useful.) Of course, what's ethical and what are the criteria are determined by the investor.

⁵ I have a friend who says SRI is whatever the loudest person in the room says it is. There surely are disputes. See The Informed Reader, When Gastronomy and Morality Collide, Wall St. J. B6 August 17, 2007; Vanessa O'Connell, The New Politics of Purses, Wall St. J. P3 (Aug. 4-5, 2007) (Whether a good person uses/buys anaconda rather than python.).

⁶ A reasonable idea, but at best only for very long term investors. If clean, caring corporations will have brighter futures than dirty, non-caring corporations, it may still take a decade or two of three for the two groups' returns to differ by a noticeable margin.

⁷ Shareholder activism may be a more efficient technique than just selling the stocks.

⁸ Engagement is primarily a political act or gesture; sometimes more a signaling technique just to keep issues in the headlines. E.g., Coke sells soft drinks in Sudan. Protesting these sales will not change Coke's profitability to any noticeable extent. If Coke stopped the sales, that would

But, surely, there are those who see SRI as a tool from the Devil's workshop, just as there are those who see standard financial tools as just as devilish.⁹

WHY NOW?

Why now? Why is SRI worth writing about today? Because social investing is hot.¹⁰

Here's why it's hot (in other words, herewith the executive summary for Rip van Winkle¹¹).

1. Current international issues and events have put SRI on the table. Sudan, the environment come to mind¹² and institutional investors love of timber investing come to mind.¹³

have no effect on the civil war. And the protests may not even cause Coke to change its policy. But it's a convenient way to keep Sudan in the public eye.

⁹ A cruel view might be that SRI is a sales strategy and a belief system more than it is a way to make money.

¹⁰ Julie Hudson, The Research Foundation of CFA Institute Publications, The Social Responsibility of the Investment Profession (2006). UBS clearly has a major commitment to SRI. Ibid. I'd been asleep at the switch and hadn't noticed the growth of SRI. "In 2005, SRI assets under management (AUM) totaled US\$2.29 trillion—or roughly one out of every ten dollars invested in public equities in the United States" Capgemini & Merrill Lynch, World Wealth Report 2007; OECD, 2007 OECD Roundtable on Corporate Responsibility <http://www.oecd.org/dataoecd/3/0/38550550.pdf>. See also THE NEW CORPORATE ACCOUNTABILITY: CORPORATE SOCIAL RESPONSIBILITY AND THE LAW, Doreen McBarnet, Aurora Voiculescu, and Tom Campbell, eds., Cambridge University Press, 2007; Haas Takes New Tack on Investing, M.B.A. Students to Run Fund Focusing on Socially Responsible Firms, Wall St. J., Sept. 18, 2007, at B8.

¹¹ Rip van Winkle is Washington Irving's titular protagonist who slept for 20 years and awoke to find the world had changed. I wrote Arguments in Favor of Fiduciary Divestment of "South African" Securities, 65 Neb. L. Rev. 209 in 1986. Basically, it's been 20 years. There are a lot of interesting factoids available for the knowing in the SRI area. For example, a lot of the exclusion is of tobacco stocks. It's not professors of cultural anthropology insisting that their pension not be invested in the stock of corporations that support neocolonialism. Excluding tobacco may lose you some profits but it won't seriously harm diversification.

¹² This is what is called "a specific event catalyst." Julie Hudson, The Social Responsibility of the Investment Profession (a research foundation of [the] CFA Institute monograph) 83 (2007). www.cfopubs.org.

¹³ One might argue that the Hershey case focused people on one facet of social investing – implied duties toward collateral stakeholders of charities. As to Hershey, see Jonathan Klick & Robert H. Sitkoff Agency Costs, Charitable Trusts, and Corporate Control: Evidence From Hershey's Kiss-Off (forthcoming 2007). As to timber see Jeremy Grantham, Special Topic: Let's All Look Like Yale, Part II, GMO Quarterly Letter, April 2007, at 1.

Simply put, bad things are happening to innocent people in Sudan and thoughtful people want to see it stopped. Student agitation to have universities divest their endowments of “Sudanese” securities has put the issue front and center just as events in South Africa had the same effect in the 1980s.¹⁴

As to environmental concern it’s convenient to claim that the Al Gore movie, *An Inconvenient Truth*,¹⁵ started that ball rolling.¹⁶ And the weather in the summer of 2007 didn’t hurt either.

As to timber, institutional investors have been having a love affair with timberland as an investment and protesting about mismanagement of timber works for some environmentalists¹⁷ and students.

As to students more generally, it seems students are more interested than in the recent past in doing good as well as doing well. For instance, it is said there is a growing population of newly minted “MBAs who prefer meaning to money.”¹⁸

¹⁴ As to Sudan, see David B. Kopel, Paul Gallant & Joanne D. Eisen, *Is Resisting Genocide a Human Right?*, 81 *Notre Dame L. Rev.* 1275 (2006). The leader of the UC effort was Adam Rosen UCD School of Law Class of 2006 who was then the UC student regent. As to South Africa see Joel C. Dobris, *Arguments in Favor of Fiduciary Divestment of "South African" Securities*, 65 *Neb. L. Rev.* 209 (1986). Divesting as used in the 1980s meant/means selling the bad stuff. We’ve gotten more sophisticated. You can sell bad stuff short or construct synthetics that have the characteristics of the bad stuff but allow you not to own it. Divestment is a neutral term although one grows used to seeing it primarily in an SRI context. See *Me and my adviser: Good resolution for divestment, Corporate Finance (Special Report)*, July 25, 2007, at 6. Blood diamonds also come to mind for a tainted product and a rallying point. *Blood Diamond* (Warner Bros. 2006).

¹⁵ *An Inconvenient Truth* (Lawrence Bender Productions 2006). Some other inconvenient truths come to mind: bankers will often lend foolishly; charities will often take dirty money and fret; and professional investors of note will often turn out to be barrow boys.

¹⁶ The useful oversimplification in the text is expanded in Paul Hawken, *Blessed Unrest* (2007) (a chronicle of recent social movements in the popular culture). I am convinced that the essence of SRI is PR. I am then reminded of John Langbein’s dictum, put in my words, that SRI is just politics in another place. See John H. Langbein, *Social Investing of Pension Funds and University Endowments: Unprincipled, Futile, and Illegal*, in *Disinvestment: Is it Legal? Is it Moral? Is it Productive?*, *An Analysis of Politicizing Investment Decisions* 1 (John Langbein et al. eds., 1985). Langbein also wrote about SRI in John H. Langbein & Richard A. Posner, *Social Investing and the Law of Trusts*, 79 *Mich. L. Rev.* 72 (1980).

¹⁷ Matt Weiser, *CalPERS Vineyard Venture Attacked*, *Sac. Bee*, Aug 5, 2007, at 1.

¹⁸ Paul Jansen, *Letter to the Editor*, *Fin. Times*, June 30/July 1, 2007, at 6; see, Chrystia Freeland, *Doing well or doing good?* *THE A-TRAIN*, June 23, 2007, at 22.

2. The SRI folks have gotten a lot more sophisticated in presenting their ideas and in slicing and dicing the SRI salami.¹⁹ The taxonomy has become quite impressive. For instance, it is commonly suggested that companies that adopt best practices from an environmental²⁰ or corporate governance viewpoint are likely to do better in the new world of the 21st century. SRI investors now consult numbers as well as emotions.

3. The SRI folks have gotten a lot better at SRI investing. They can exclude “bad” stocks²¹ (or include “good” ones) in portfolios and match, or even exceed bench-marked returns, over short periods of time. It would appear they got these returns during the period measured at a cost of taking on more risk, but they tend to ignore the risk part of the equation in presenting the SRI case,²² to call the risk a risk worth taking,²³ or to make the claim there is no increase in risk.

In the old days, SRI could be easily dismissed as a low return²⁴ venture, but less so lately, when recent returns are used²⁵ and when the focus is on return.

¹⁹ Continuing with the food images, one might argue that there’s nothing new here; that we are just dealing with mutton dressed as lamb.

²⁰ Observer, The greening of T. Boone Pickens, 8 Fin. Times, July 20, 2007, at 8 (“As unlikely as it sounds, Pickens [a noted corporate raider and nonSRI activist investor] sees profits in environmentalism.”)

²¹ By “bad” I mean offense to the SRI investor in question.

²² Over longer periods of time the extra risk should lead to lower returns.

²³ Risk is usefully defined in Jonathan R. Macey, American College of Trust & Estate Counsel Foundation, An Introduction to Modern Financial Theory 18 (1991) (“[T]he concept of risk is best understood as the variance among possible outcomes associated with a particular investment.” If you’d prefer a different Macey quote, see, pg 13: “[I]n thinking about risk, one should be aware of the fact that the idea of risk not only refers to the possibility of default, but also to the degree of dispersion among possible outcomes.”). As to Macey’s authority, see John H. Langbein, The Uniform Prudent Investor Act and the Future of Trust Investing, 81 Iowa L. Rev. 641 n. 21 (1996) (“A convenient exposition for lawyers is Jonathan R. Macey, An Introduction to Modern Financial Theory (1991) (American College of Trust & Estate Counsel Foundation).”). See generally Bevis Longstreth, Modern Investment Management and the Prudent Man Rule (1986).

²⁴ The case against SRI is that returns are lower or that even if not lower they are obtained at a greater risk. If one is hostile to charities with perpetual existence, perhaps because of concerns about dead hand control (a big “if”) then lower returns, especially when coupled with 5% payouts mandated by private foundation rules (or paid out because of a belief that 5% payouts can be sustained) will eventually undermine the charity. For some that would be a good thing.

²⁵ Performance table: UBS Social Responsibility Funds, www.ubs.com/2/e/files/SRFU_tech.pdf. Generally, it is to be noted that an important commentator on SRI is Peter Kinder. See Peter D. Kinder <http://www.kld.com/resources/papers/SRIevolving050901.pdf>

Thus, I am tempted to say modern SRI investing is more about risk than it is about return. And then I suggest we are left with the question, “When can a fiduciary take extra risk, in all likelihood by screening out unloved assets, and not get successfully sued?”²⁶ A

²⁶ The problem is, a wise friend said, the unloved assets offer the better return because no one wants them, by definition. Often they draw the dividend investor or the value investor or the contrarian. Arne Alsin, *Inside Curve: Deals get left in the basement by short-sighted bargain-hunters*, *Fin. Times*, July 28/July 29, 2007, at 4.

Screens, filters, exclusion, aversion investing, they’re all the same thing I believe.

As to the statement in text, the point may be when can a fiduciary get a lawyer to bless the investment. Successful suit for lost opportunity outside the ERISA arena may be more imaginary than real at this time.

One might argue that given enough Graham and Dodd analysis, and/or given enough cleverness with derivatives, that SRI portfolios could be constructed that gave up little or no gross return and that took on board little extra risk. But “Oh the cost!” If so, then one might hope for reduced transaction costs over time. How? Several ways come to mind. Perhaps our friends the machines will help us. Artificial intelligence. Enhanced computers. Better algorithms. Maybe volunteers will help us. PC time could be donated. SRI law students and MBA students could take up tasks and SRI could be improved the way Linux is or a Wiki is. Small tasks could be done for pay. If every pension fund in the country bought SRI advice the product might well improve and the price might go down. SRI and pensions are considered in Keith Ambachtsheer, *Pension Funds and the ‘SRI’ Movement: Still Ships Passing in the Night*, *The Ambachtsheer Letter* # 254 (March 2007) (Copy on file with author). Interestingly Ambachtsheer’s daughter is an SRI advocate as the cited newsletter makes clear. She is the head of SRI investing for Mercer Consulting. See <http://www.merceric.com/summary.jhtml?idContent=1174905>.

Lists of clean funds that make no SRI claim could be published and list of stocks as well. The truth is that if no SRI claim was made by a trustee and if he was willing to fib and say SRI was the farthest thing from his mind then who’s to say that a nonSRI “SRI” fund or portfolio was chosen for forbidden SRI purposes. This “truth” suggests that some SRI investing might be done for bragging rights. Similarly the trustee who invests in well governed corporations because she believes they are likely to be the most profitable likely is less open to successful suit than the trustee who made the same investments because of a personal belief in SRI investing as a matter of morality. Put another way if I, a fiduciary, invest in Costco silently or because I think their compassionate labor policies will lead to increased profit for them and my trust then I am much less likely to be successfully sued than if I invest in them because it makes me feel better to invest in a company that is kind to its workers.

If a fiduciary invests in SRI at a cost in risk or return to please himself that is a breach of the duty of loyalty. If he does it to please some of the beneficiaries and there is a financial cost he’s breaching his duty of impartiality (to the nonSRI beneficiaries) and his duty to invest competently. If truly all of the beneficiaries want SRI investing they can set aside any relevant duties or it could be claimed they were in receipt of psychic income. For a recent non-American view of the duty of loyalty see, Rebecca Lee, *In Search of the Nature and Function of Fiduciary Loyalty: Some Observations on Conaglen’s Analysis*, 27 *Oxford J. Leg. Studies* 327 (2007).

The trustee who is making money can theoretically be sued for making it the wrong way or (less likely) for not making enough, but that suit is unlikely to be brought and if brought it is unlikely to be won. IF the suit is for not making enough money will that ever succeed? Is it possible there’s no monster in the closet? At least in up markets? The trustee who has lost money may or may not be successfully sued. Two trustees could make the same investment in a loss-making investment and one might properly be surcharged and the other might not. How so? First, because what’s right for one trust might be wrong for another. Second, because it’s not whether you win or lose, it’s how you play the game. If trustee A gives the matter serious consideration trustee A may well get off the hook. If trustee B makes the investment in a cavalier fashion, trustee B may be surcharged.

return obtained at the cost of higher risk when the same return is obtainable at lower risk is inferior. Let me say such a return is second best.²⁷

4. Tons more assets are under, and will come under, something called SRI management.²⁸ The decision of more and more people to invest in something they call SRI inevitably makes SRI less about biodynamic farming and more about the mainstream. And that current in the mainstream is leaching into the world of fiduciary investing.²⁹

And, there's gold in them thar hills.³⁰ Rich people, especially outside the US, seem very interested in SRI for their own portfolios.³¹ For instance, UBS (an international Swiss-based bank) seems to have a

If A made the investment after performing a meaningful and rational investigation and going through a meaningful and rational process of thought she is unlikely to be successfully sued. If B made the investment because the Tarot cards told him to B is likely to be successfully sued if there is a loss. [If there are gains, most folks will look the other way.]

Until recently, SRI was, for many people, in the Taro card category. Now many people are much slower to dismiss SRI.

Forbidding SRI when it's so easy to explain a clean investment without referring to SRI leaves us with a situation where trustees are indirectly encouraged to lie. This is socially unwholesome and wasteful of judicial resources – we have to reserve court time for determining the trustee's state of mind when he bought the Stanhope & Hopeworthy Growth and Income Fund (a fund that just happens to conveniently be a clean fund from an SRI viewpoint).

²⁷ And then I am moved to ask what are the situations where a brave trustee might eschew "best" for "second best" and hope to escape a successful lawsuit (or even a costly unsuccessful law suit). I have often thought that second best is actually often best in the trusts and estates world and perhaps this is one of the places that that is the case.

²⁸ Michael S. Knoll, *Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment*, 57 *Bus. Law.* 681 (2002). Having said that I am less than certain that large percentages of capital are under SRI management. Cf., Andrew C. Revkin & Matthew I. Wald, *Solar Power Captures Imagination, Not Money*, *N.Y. Times*, July 16, 2007, at 1.

²⁹ William Baue, *Institutional Investors Drive Research on Mainstreaming of SRI by Investment Managers*, <http://www.socialfunds.com/news/article.cgi/1840.html> (quoting Jane Ambachtsheer). Not all worthy considerations of SRI are mainstream. See Benjamin J. Richardson, *Protecting Indigenous Peoples through Socially Responsible Investment*, 6 *Indigenous L.J.* (forthcoming 2007).

³⁰ KLD is a leader in the SRI investing industry. In June 2007 KLD claims that more than \$10 billion is invested using KLD SRI/ESG indices. http://www.kld.com/newsletter/archive/press/pdf/200706_Index_Performance.pdf. Of course, \$10 billion is not a lot of money. As of January 2007 the Gates Foundation was said to have \$35 billion. KLD is the leading SRI indexer. They have competition. There now exists the FTSE4GoodIndex. *Fin. Times*. Advertisement, August 15, 2007, at 1.

³¹ *World Wealth Report*. Similarly, Norway has a huge amount of oil money invested according to SRI principles and companies take it seriously. Peter Wilson, *Knut cracks the fund manager pay myth*, *Weekend Australian*, Nov. 18, 2006 at 38. See also David Ibison, *Transparency key as Norway sets standards*, *Fin. Times*, Aug. 31, 2007, at 3 ("Oslo's clean and open approach to asset management is a lesson to others.").

major commitment to the sector.³² Then it seems appropriate to say, Don't stand between a banker and her profits.³³

And it seems likely that more assets will come under SRI management.

How so? The death of the defined benefit pension plan and the rise of the defined contribution plan mean that individuals³⁴ can hold SRI investments for their pensions without the intervention of fiduciary law.³⁵ This change also means that those who would defend the defined pension benefit fortress will find that fortress disappearing into the sands. As my friend said, "Our time is passing into history."

³² A leading proponent of SRI is Julie Hudson, an employee of UBS. See Julie Hudson, *The Social Responsibility of the Investment Profession* (a research foundation of [the] CFA Institute monograph). www.cfopubs.org. 83, 85 (2007).

³³ Show the bankers on the sales side of the trust department that there is profit in SRI and stand back. Bankers get what they want from state legislatures. Joel C. Dobris, *Why Five - The Strange, Magnetic, and Mesmerizing Affect of the Five Percent Unitrust and Spending Rate on Settlers, Their Advisers, and Retirees* Dobris, 40 *Real Prop. Prob. & Tr. J.* 39, 51 (2005-2006).

³⁴ It's never suggested that the claims of SRI investment sponsors are tortious or even criminal. Huh? "You can get superior returns with an SRI portfolio." Just puffing. And SEC regulations undoubtedly make the documents that underlie any SRI mutual fund very informative.

³⁵ See *Does your company's retirement plan include an ethical investing option?*, <http://www.csmonitor.com/2007/0618/p25s01-wmgn.html>. Query how many folks will make the election. *Ibid.* Fifteen percent of TIAA-CREF participants do so. The percentage is low because of performance concerns. *Ibid.* I am reminded of a friend of mine who was trustee for her siblings. She initially invested in an SRI mutual fund, but saw the returns were lower. She felt, contrary to her hopes and general beliefs, that she couldn't penalize her siblings for her desire to invest in an SRI fund. See Diana Ransom, *Starting Out: Ways to Do Your Share*, *Wall St. J. Sunday* as reprinted in the *Sacramento Bee*, August 5, 2007, at D7 ("... 19% of defined-contribution plans include an SRI option. And at 41% of other defined-contribution plans, the sponsors intend to add an SRI fund option within three years.").

SRI pension investing is considered in a number of places including: Paul Palmer et al., *Socially Responsible Investment: A Guide for Pension Schemes and Charities* (Charles Scanlan ed., 2005); Edward S. Adams & Karl D. Knudsen, *A Charitable Corporate Giving Justification for the Socially Responsible Investment of Pension Funds: A Populist Argument for the Public Use of Private Wealth*, 80 *Iowa L. Rev.* 211 (1994); Stephen P. Ferris & Karl P. Rykaczewski, *Social Investment and the Management of Pension Portfolios*, 40 *J. Am. Soc'y. C.L.U.* 60 (1986); John H. Langbein, *Social Investing of Pension Funds and University Endowments, Unprincipled, Futile and Illegal*, in *Disinvestment: Is It Legal?, Is It Moral? Is It Productive?* (National Legal Center for the Public Interest, Washington 1985); Ian D. Lanoff, *The Social Investment of Private Pension Plan Assets: May It Be Done Lawfully Under ERISA?*, 31 *Lab. L.J.* 387 (1980); Robert J. Lynn, *Investing Pension Funds for Social Goals Requires Changing the Law*, 53 *U. Colo. L. Rev.* 101 (1981); Benjamin J. Richardson, *Do the Fiduciary Duties of Pension Funds Hinder Socially Responsible Investment?*, 22 *Banking & Fin. L. Rev.* 145 (2007); S. Prakash Sethi, *Investing in Socially Responsible Companies is a Must for Public Pension Funds – Because There is No Better Alternative*, 56 *J. Bus. Ethics* 99 (2005); Thomas A. Troyer et al., *Divestment of South African Investments: The Legal Implications for Foundations, Other Charitable Institutions and Pension Funds*, 74 *Geo. L.J.* 127 (1985).

Private defined benefit pensions are the toughest nut to crack for SRI snackers. Plan sponsor and trustee hunger for return is huge, so there's little room for sentiment, and the guardians are many.³⁶ Plus, ERISA and its interpretations leave only a dime to stand on. Having said that, I feel compelled to note that the UN pension fund does not invest in arms manufacturers.³⁷ Of course! The idea that the UN is supposed to invest for superior return in armaments is ludicrous.³⁸ Duh.³⁹

And we just seem to be in a moment when the claims of SRI make more sense to more people.⁴⁰ People "want to make a difference" and they like the two-fer of their investments doing it for them. Why earn dirty money and then make clean donations? Look for the win-win situation. Chalk it up to the environment and the quick spread of information. Focusing on my second point, global warming and environmental concern are causing more and more people to want to be SRI investors. And the feeling of political powerlessness in 2007 America felt by many, contributes, I would submit, to the need to have some impact.

³⁶ John Langbein comes to mind. See John H. Langbein, *Social Investing of Pension Funds and University Endowments: Unprincipled, Futile, and Illegal*, in *Disinvestment: Is it Legal? Is it Moral? Is it Productive?*, An Analysis of Politicizing Investment Decisions 1 (John Langbein et al. eds., 1985).

³⁷ Steve Johnson, *Hands-on investor: Matchmaking at the Double*, *Fin. Times*, June 30/July 1, 2007, at *Life & Arts* 4.

³⁸ Basil Zaharoff to the contrary notwithstanding. Or, that a manufacturer of Catholic raiment has to invest its pension fund in contraceptive makers for superior returns.

³⁹ ERISA doesn't affect the UN but it is instructive.

⁴⁰ *Observer*, *Sell signal* 8 *Fin. Times* Aug. 15, 2007 ("... [A] recent survey shows that investors say they would sell shares in companies if they knew unethical practices were taking place - even if the shares were rising. Three out of four investors say they would pull their money if they found out a company was profiting from unethical activity. The question asked by Pepperdine University was about acts that were unethical yet legal, thus with no potential for stock-price-depressing lawsuits. Nearly 40 per cent of the 500 investors that Pepperdine polled said they would definitely move their money, and an additional 38 per cent said they would probably move it.

As it turns out, the big individual investors - those polled had at least \$100,000 in stocks and mutual funds - also favour putting corporate officers and board members behind bars.

Nine out of 10 investors said convicted officers and board members should serve some jail time. Only 7 per cent of investors said they shouldn't be required to go to jail.

Of course, these are all hypothetical situations. It might be a slightly different question when you're actually holding a soaring stock.").

It's a world gone mad and people want to do something about it.⁴¹

5. There is always a population of people who see their wealth as an extension of themselves and who want to vote with their money. This is a time of prosperity and inheritance and so the population of rich people is expanding and so, inevitably is the population of people who want to invest "responsibly."

More specifically, there's a generation of young people who have money and are uncomfortable investing it only for financial gain. There is a population of people who are earning their money in their youth and/or inheriting in their youth and SRI investors, I believe, tend to be young.⁴²

The thought extends to human capital as well. There is a population of young MBAs who want to invest their human capital in goodness.⁴³

6. Thinking about SRI and associated topics has gotten more interesting for academics. For example, in the parallel universe of corporate governance, corporate law/business/finance profs seek to understand if obsessive profit maximization, carries unacceptable social costs⁴⁴ and they are investigating whether implementing

⁴¹ See Does your company's retirement plan include an ethical investing option? <http://www.csmonitor.com/2007/0618/p25s01-wmgn.html>. Professor Vandenberg of Vanderbilt tells us that we should take more responsibility as individuals in reducing pollution. I think it is fair to say, in the same vein, that some of us feel the urge to boycott when we spend and perhaps when we pick individual stocks but not when we invest in pooled funds. The feeling of individual responsibility pales as one moves along that spectrum. See Michael P. Vandenberg, *The Individual as Polluter* 35 *Env'tl. L. Rev.* 10, 723 (2005); Daniel A. Farber, *Controlling Pollution by Individuals and other Disbursed Sources*, 35 *Env'tl. L. Rev.* 10,745 (2005). Some people say they are ethical spenders when they aren't. See Michael Skapinker, *There is good trade in ethical retailing*, *Fin. Times*, Sept. 11, 2007, at 11 (Discusses the 30:3 rule – thirty percent of shoppers in the UK claim to think about ethical issues when shopping but only three percent actually do). John Authers, a leading investment columnist for the *Financial Times* seems almost at peace with SRI. John Authers, *There are clear arguments for a clear conscience*, *Fin. Times*, July 29/29, 2007, at 12.

⁴² Or young at heart. As to the text, see *World Wealth Report* (2007)

⁴³ Chrystia Freeland, *Doing well or doing good? THE A-TRAIN*, June 23, 2007, at 22; Rebecca Knight, *Why the good life could turn out to be the hardest sell of all*, *Fin. Times*, Aug. 20, 2007, at 10. Similar themes are discussed in Bruce Piasecki, *The social responsibility revolution; It's not just about PR anymore; Firms see big profits in green solutions*, <http://www.csmonitor.com/2007/0809/p09s01-coop.htm> (Aug. 9, 2007).

⁴⁴ As to the sentence in the text, see generally Irene Lynch Fannon, *The Corporate Social Responsibility Movement and Law's Empire: Is There a Conflict?* 58 *N. Ireland Legal Quarterly* 1 (2007).

corporate governance regimes leads to enhanced market values⁴⁵ and whether hedge funds⁴⁶ have an effect on corporate governance.⁴⁷

Similarly, the writing about SRI on both sides of the argument has advanced beyond chanting slogans across the table at faculty dinner parties on Saturday night.⁴⁸

7. The tools of SRI have been co-opted for mainstream purposes.⁴⁹ For instance, the SEC has adopted and adapted the SRI tool of “blacklisting” corporations that enhance terrorism.⁵⁰ If it’s good

⁴⁵ Bernard S. Black & Vikramaditya S. Khanna, Can Corporate Governance Reforms Increase Firms’ Market Values? Evidence From India, <http://ssrn.com/abstract=914440> (2007). Commercial entities seek to rate companies on the quality of their corporate citizenship to allow for increased investing profit. See Phred Dvorak, Theory & Practice: Finding the Best Measure of ‘Corporate Citizenship,’ Wall St. J. B3 (2007). Limited data suggests that screening for good corporate citizenship leads to excess returns. Ibid. “Skeptics say studies of governance practices and share performances are skewed by other factors such as industry results.” Ibid. The same complaint could be lodged against short term studies of SRI results.

If a corporation’s SRI policies are costing it profits that does not suggest that it is improperly priced in the stock market. Anything is a bargain at the right price. Highly diversified portfolios will likely include such corporations. Ben and Jerry’s with its unusually high contributions to charity is properly priced. Everyone knows they give away some profits reducing the company’s value. No one buys the stock thinking they will get the full return on earnings. The problem comes when the investor constrains her portfolio to include only SRI companies, all properly priced by the market. This is not a problem only if those who plead for unconstrained portfolios are wrong or if fancy derivative or synthetic arrangements can cure the constraint weakness. For an article taking the position that SRI constraints reduce optimized return see, Eric Girard, Hamid Rahman & Brett Stone, Socially Responsible Investments: Goody-Two-Shoes or Bad to the Bone?, 16 J. Investing 96 (2007).

⁴⁶ “Hedge funds ... typically invest in liquid securities, with no control. They have the flexibility to take both long and short positions” The Lex Column, Relative values, Fin. Times, July 9, 2007, at 14. For a straight forward discussion of hedge funds see, Triphon Phumiwasana, Tong Li, James R. Barth, & Glenn Yago, Insights, The Hedge Fund Behemoth, 9 The Milken Inst. Rev. 81 (2007)

⁴⁷ William W. Bratton, Hedge Funds and Governance Targets, 95 Geo. L. J. 1375 (2007); Marcel Kahan & Edward B. Rock, Hedge Funds in Corporate Governance and Corporate Control, 155 U. Penn. L. Rev. 1021 (2007) (Hedge funds are more suited to active involvement in corporate governance than mutual funds.). Hitching a free ride on the hedge fund bandwagon would yield quite a ride for those who would change corporate conduct. One does not toy with hedge fund managers is my impression.

⁴⁸ Compare Julie Hudson, The Social Responsibility of the Investment Profession (a research foundation of [the] CFA Institute monograph). www.cfopubs.org. 83, 85 (2007) with Michael S. Knoll, Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment, 57 Bus. Law. 681 (2002).

⁴⁹ See Maria Markham Thompson, Pro & Con: Moral Considerations in Investing; Socially Responsible Investing Has Become a Mainstream Practice, <http://chronicle.com/weekly/v50/i38/38b02041.htm> (2004) (subscription required).

⁵⁰ Jeremy Grant, Blue-chip companies voice fury over SEC terrorism ‘blacklist,’ Fin. Times, June 29, 2007, at 1. The SEC was having second thoughts in late July, but the point remains valid,

enough for Uncle Sam it's good enough for the SRI folks. As Lionel Trilling wrote: "Time has the effect of seeming to quiet the work of art, domesticating it and making it into a classic [U]niversity study tends to accelerate the process by which the radical and subversive work becomes the classic work."⁵¹ We've gotten used to it.

8. Activist investing is in fashion. Activist investing comes in many forms.⁵² In broad form, it's about investors who take a position in a company's shares and then start telling the managers what to do, usually how the new investor/owner wants the company run, usually to improve performance, the performance in question usually being financial performance. SRI is just a sub-form of (currently fashionable) activist investing.⁵³

9. So-called mission investing has come to the fore in the nonprofit world, making fuzzy the formerly clear boundary between investing for gain and granting for charitable purposes. Mission investing is "the practice of using financial investments as tools to achieve a foundation's mission. Mission investing is a more specific type of social investing—the broader approach of considering social and environmental factors, whether or not directly related to mission, in investment decisions."⁵⁴ This use of investment funds to advance

nonetheless. See Floyd Norris, S.E.C. Rethinks Lists Linking Companies and Terrorist States, N.Y. Times, July 21, 2007, at B2. It is easy to think of divestment as a tool of the "progressive" left. The use of divestment by the Bush government suggests this is not so. Indeed, right of center politicians in state legislatures have been calling for divestiture by public pension funds of the shares of corporations that do business in Iran. This has led, I believe, pension trustees to press Shell oil to leave Iran (so that they are not forced to divest their portfolios of Shell stock). See Rebecca Bream, US funds hit at Shell over Iran, Fin. Times, July 26, 2007, at 21. As to Iran exclusion see KLD <http://blog.kld.com/sudan/sudan-and-iran-divestment-campaigns>. See also G. Jeffrey MacDonald, Social conservatives rally an investor army, <http://www.csmonitor.com/2007/0423/p13s01-wmgn.html> (April 23, 2007).

⁵¹ Lionel Trilling, *On the Teaching of Modern Literature*. (1961).

⁵² Activist investing is a broad and abstract term. A useful definition might be taking a (usually meaningful) stake in a corporation and then agitating for conduct designed to increase profits. Often that means agitating for better corporate governance. For a useful essay on hedge fund moguls as wholesome corporate activists see William W. Bratton, *Hedge Funds and Governance Targets*, 95 *Geo. L. J.* 1375 (2007).

⁵³ It seems to be a moment in time when a subpopulation feels responsible for its actions as investors and charitable contributors. It's reminiscent of the 60s. SRI activist investing is discussed in Dashka Slater, *Resolved: Public Corporations Shall Take Us Seriously*, N.Y. Times Sunday Mag., Aug. 12, 2007, at 22. See also Siew Teoh et al., *Effect of Socially Activist Investment Policies on the Financial Markets: Evidence from the South African Boycott*, 72 *J. Bus.* 35 (1999).

⁵⁴ Sarah Cooch & Mark Kramer, *Compounding Impact: Mission Investing by U.S. Foundations* 6 (2007) (funded by the David & Lucile Packard Foundation); Jed Emerson, where MONEY meets

social goals has the potential for leaching into 'pure' fiduciary investing. When mission investing is merged with traditional investing this hybrid makes the bitter pill of SRI easier to swallow and has the potential of making less clear the border between ordinary investing for pecuniary gain and SRI.

10. Fourth sector/Hybrid investing/venture philanthropy⁵⁵ is in vogue and it bangs up against SRI.⁵⁶ This is about combining attitudes,

MISSION, Stan. Soc. Innovation Rev., Summer 2003, at 38; Jed Emerson & Mark Kramer, Maximizing Our Missions, Chron. Philanthropy, Jan. 25, 2007. The Gates Foundation was scolded for investing against their mission. They chose to ignore the fuss. See Charles Piller, Berkshire Wealth Clashes with Gates Mission in Sudan, LA Times, May 4, 2007, available at <http://www.latimes.com/news/nationworld/nation/la-na-berkshire4may04,0,07433631.full.story?coll=la-home-headlines>; Charles Piller, Buffett Rebuffs Efforts to Rate Corporate Conduct, LA Times, May 7, 2007, available at <http://www.latimes.com/news/nationworld/nation/la-na-berkshire7May07,1,2180048.story?coll=la-headlines-business>; Charles Piller, Money Clashes with Mission, LA Times, Jan. 8, 2007, available at <http://www.latimes.com/news/nationworld/nation/la-na-gates8jan08,0,7911824.story?coll=la-home-headlines>; Charles Piller, et. al., Dark Cloud Over Good Works of Gates Foundation, LA Times, Jan. 7, 2007, available at <http://www.latimes.com/news/nationworld/nation/la-na-gatesx07jan07,0,6827615.story>; Divestment from Sudan: A moral sense, Economist, May 12, 2007, at 31.

⁵⁵ One definition of venture philanthropy is foundations investing in experimental drugs both for profit and to insure the drug comes to market, when normal methods for funding experimental drugs fail. See Kai Ryssdal & Janet Babin, A Different Sort of Venture (American Public Media Broadcast transcript June 8, 2007) (Lexis). Broader definitions exist. New forms of philanthropy are fashionable. "The new generation ... philanthropists is looking to give back to society through a much broader range of activities than was previously the case." Capgemini & Merrill Lynch, World Wealth Report 2007. Another definition of venture philanthropy is applying business metrics to purely charitable donations. Is the soup kitchen getting the best deal on carrots? See generally Rachel Emma Silverman, A New Generation Reinvents Philanthropy, Wall St. J., Aug. 21, 2007, at D1 ("Blogs, Social-Networking Sites Give 20-Somethings a Means To Push, Fund Favorite Causes."); Sean Stannard-Stockton, Philanthropy not just for the ultra-rich, Fin. Times, (Life & Arts), Aug. 25/26, 2007, at 4 ("Some tactical philanthropists argue that you can make a profit while advancing your philanthropic interests. San Francisco-based Good Capital operates like a venture capital fund. It invests money from wealthy individuals and distributes earnings back to investors. The difference is that Good Capital invests in non-profit organisations as well as for-profit ones that perform functions associated with non-profit charities.")

⁵⁶ James Mackintosh, The New Philanthropy: Feared fund turns to business of charity, pg. 4 Fin. Times, July 2, 2007 ("...bringing business rigour and a private sector approach into development."). Kate Burgess, Companies buy into the notion of giving something back, Fin. Times, July 2, 2007, at 4; Stephanie Strom, Make Money, Save the World, N.Y. Times Sunday § 3, at 1; Money and Business/Financial Desk, May 6, 2007, at 1. One vague definition is "a hybrid organizational form -- part nonprofit, part for-profit -- what some are calling 'the fourth sector,' a social-benefit enterprise." Clint Wilkins, A Nonprofit Leader Builds His Encore Career, The Chronicle of Philanthropy, September 14, 2006, at 44. See briefcase, Brisbane City News (Australia) October 6, 2005, speaking of a particular enterprise: "... [the founder's] philosophies are imbedded in the fairly new 'fourth sector' concept and its ultimate aim is to produce entrepreneurs with businesses that are not only profitable but which also operate in a socially, culturally and environmentally responsible way." For a contrary view see, N.Y. Times, Section 3;

structures, methods and metrics of the profit and nonprofit corporate worlds. It's a loose amalgam of ideas, notions, outlooks and the like that include: charities are sleepy and need a good kick in the butt from folks who understand modern business methods; well run businesses produce so much excess profit that some of the excess profit (or the ability to make profit) can be shared; the new generation of technocrat entrepreneurs are somehow better people and better managers than the J.P. Morgans of the world (and even the Andrew Carnegies and John Rockefellers of the world); this new generation wants to, and can easily share, their human capital and a bit of their cash in new and exciting ways with those less fortunate through investing in the so-called fourth sector via hybrid entities and bespoke venture capitalism,⁵⁷ that managing risk and adapting to new markets can be enhanced by philanthropic and partner activities with NGOs and nonprofits⁵⁸ and that business corporations can grow and renew themselves by better understanding the nonprofit world.⁵⁹ There, in a paragraph, is the fourth sector. Whew.

Column 5; Money and Business/Financial Desk, May 7, 2007, at 7, Salve for the Conscience: "To the Editor: The corporate/nonprofit hybrids of the "fourth sector" ("Make Money, Save the World," May 6) are a sure-fire formula for confusion, conflict of interest, deception and outright fraud. They join "eco-friendly tourism" and "carbon credits" for guilt-stricken, environmentally conscious travelers. Such feel-good substitutes for meaningful government action are themselves inadequately regulated, and merely lull people into the mistaken belief that they are making a significant contribution to curing social ills that can be dealt with effectively only through legislative, regulatory and judicial means." JOHN S. KOPPEL Bethesda, Md. Further discussion is to be found in Kathryn Tully, Charity that offers fair profit, Fin. Times, July 28/July 29, 2007, at 4. See also Stephanie Strom, Ex-Wall St. Executives Go to Bat to Help Nonprofits, N.Y. Times, August 3, 2007, at C3 (Using Wall Street ways to raise funds for charity.).

⁵⁷ See Richard C. Morais, Charity Made Efficient, Forbes, June 25, 2007; see also Face Value: Book Value, The Economist, July 21, 2007, at 66 ("He also happens to believe, rather as Google's young founders do, that he can, and should, change the world."); James Flanigan, Community Investment in San Jose, N.Y. Times, July 19, 2007, at C9; Face Value: Leader of the Swarm, The Economist, July 14, 2007, at 74.

⁵⁸ For an intriguing story on a Proctor and Gamble's venture into hybridicity see Claudia H. Deutsch, A Reverse Profit Strategy Faces a Commercial Test, N.Y. Times, July 24, 2007, at C7. See also David Watts Barton, Dessert Green, Sac. Bee Aug 24 2007, at J1, J8 ("We're marrying venture capital with social capital to give poor communities a seat at the renewable energy table.")

⁵⁹ Google.org and General Electric's Ecomagination come to mind. The following extract from a help wanted ad for a job at Google.org might help: "Investments Researcher - ... Google.org is looking for an Investments Researcher to assist with evaluating "triple bottom line" investments in companies and projects, the primary goal of which will be positive and scalable impact on global public health, economic development and climate change. ...[Y]ou will work ... identifying and evaluating partnership and investment opportunities consistent with Google.org's mission.Responsibilities: Play an integral role in evaluating investment opportunities and projects consistent with Google.org's philanthropic mission. ... [Assist] with decisions relating to

Fourth sector investing is good for the business with which it is associated. It is good branding. I propose that Google's and GE's fourth sector investing makes Google and, to a lesser extent, GE cool and hip and cutting edge and makes it easier to attract and keep top employees, something that is a constant concern of those companies and any company that needs to recruit and hold technocratic, mind workers.

11. Beneficiary rights are in fashion these days and SRI in private trusts is, I believe, beneficiary driven. I say SRI is beneficiary driven because if the settlor was so inclined he'd likely have put SRI boilerplate in the trust. Beneficiaries are empowered by the times,⁶⁰ and, because a number of trusts are formed for tax reasons only, beneficiaries are often full fledged adults, and they're pushy. They are not grateful and weak widows and orphans. They are assertive. So, when a beneficiary says, "Grampie's money in the trust he set up for me, as invested by you, makes me feel dirty"⁶¹ something may have to be done about it.⁶²

Simplest of recaps: a lot of people are investing their own money in something called SRI and some people are investing other people's money (OPM) in something called SRI and it ain't going away.

LOOKING AHEAD

investments in the areas of public health, economic development and climate change.... Strong knowledge of issues surrounding climate change, global economic development and/or public health For a fascinating tale of an ad agency founded pitch for nonprofits that found a much larger clientele among profit clients see Stephanie King, Agency's Social Responsibility Focus, Wall St. J. 3B (August 17, 2007).

⁶⁰ See Heirs Handbook Home Page, <http://www.heirs.net/handbook.html>.

⁶¹ "Most carbon offsetting resembles the medieval system of indulgences where sin was absolved for haggled fees." Jonathan Guthria, How I was deluded by my carbon footprint, Financial Times, May 3, 2007, at 15. This may be a proper point to speak of mutton dressed as lamb. The 2007 graduating class of the Yale School of Forestry & Environmental Studies bought carbon offsets for their family members coming to graduation from three organizations: The Conservation Fund, Native Energy and CarbonFund.org. See Graduates offset travel emissions, Yale Alumni Magazine, July/August 2007, at 83.

⁶² If an investment makes someone feel dirty and activism leading to change is out of the question the only solution is to sell the investment -- divesting.

1. I imagine that SRI will become ever more respectable, for a variety of reasons, and that it will be more acceptable in the investing of trusted capital in particular, in some but not all, situations. In other words, a more “relaxed” and situational standard (or standards) of fiduciary duty, as to SRI, will emerge.

2. Lawyers and judges will come to more easily see an implicit setting aside, in part, of the fiduciary duties that currently seem to forbid (or at least frown on) SRI.

3. Spine-endowed trustees will ignore conservative legal advice and make investments their lawyers don't like. And no one will die. And more such investments will be made. And one day it will be more acceptable.

Most fiduciaries, and fiduciary investors more specifically, are conservative and they are advised by conservative lawyers.⁶³ Thus, investors in charge of funds set aside for nonprofit purposes⁶⁴ like

⁶³ Lawyers sell what-if advice and focus on the negative outlier, the black swan. What if a yellow dog wearing a blue collar bites a beautiful baby with malaria and then steals the neighbors' dinner you just might be liable so I wouldn't do that. Sometimes a client needs to say thank you and 'disobey' her lawyer. Yellow dog, black swan, it's all the same. Nassim Nicholas Taleb, *The Black Swan: The Impact of the Highly Improbable* (2007); Nassim Nicholas Taleb, *Foiled by Randomness: The Hidden Role of Chance in the Markets and in Life* (2d ed. 2005). Gillian Tett and Anuj Gangahar discuss the piling up of several 100,000 years events in *System error: Why computer models proved unequal to market turmoil* *Fin. Times* 7, August 15, 2007.

A few greater truths in regard to this footnote and the associated text: Trustees of charities are likely to have lawyers and seek legal advice. See Sheri Qualters, *Nonprofits scramble under new scrutiny*, *Nat'l Law J.*, Sept. 3, 2007, at 1. Ditto bank trust officers acting for the bank as trustee of private trusts. Individuals acting as trustees of family trusts are likely to act without legal advice and so might very well engage in SRI investing. A friend of the author did that very thing and switched out of SRI investing when she saw it was reducing income for her siblings. Perhaps one of these trustees will be sued someday and we'll get some law on the subject.

The world of trust fund and charity fund investing, unlike the world of college endowment investing, is often as conservative as the world of real estate titles. Most trustees are risk averse and so are most lawyers who represent trustees. And everyone is doing the world a favor by acting as a charitable trustee or lawyer for a charitable trustee. it's often pro-bono or quasi-pro-bono. So why should a trustee take a risk and act without a lawyer's blessing? And why should a lawyer bless a questionable act when he's working for free or less than his normal rate? "I can't believe that the only time I got sued for malpractice was the time I told a charity it was OK to _____ and I'd cut my time by 50% for the SOBs and they sued me."

⁶⁴ I am being purposely vague in the text. For discussion of nonprofit investing see, e.g., Harvey P. Dale, *Nonprofit Directors and Officers – Duties and Liabilities for Investment Decisions*, 22 *N.Y.U. Tax Plan.* 501(c)(3) *Org. ch. 4* (1994); Harvey P. Dale & Michael Gwinnell, *Time for Change: Charity Investment and Modern Portfolio Theory*, 3 *Charity L. & Prac. Rev.* 89 (1995); Susan N. Gary, *Symposium: State-Level Legal Reform of the Law of Nonprofit Organizations:*

their lawyers to bless their conduct, especially their unconventional financial acts. Lawyers don't like to bless the unknown and refuse. Most trustees stop at that point—they won't act without a lawyer's blessing. Nonprofiteers often blame this state of affairs (no SRI investing) on the lawyers. I would suggest there's also room to blame spineless trustees.⁶⁵

Lawyers are rule obedient and ultimately SRI folks seem to accept that. The SRI community focus has been on changing the rules – on changing the law of fiduciary investment through law reform.⁶⁶ The ALI's Restatement of Trusts, 3d, the Uniform Trust Code and UPMIFA have given them little cause for joy. What little hope there is, is to be found in the Restatement. It is no surprise that the Uniform Acts haven't done much for SRI. NCCUSL is populated by a very conservative bunch. They move slowly.

How about the common law? There's very little litigation about SRI and this means that the law is unclear and that it hasn't caught up with any trustees on the ground who are doing new things. A trustee who has acted reasonably, but in a new way, has to get sued and successfully defend herself before the common law changes. SRI needs an unsuccessful attack on a very sympathetic defendant trustee, whom no judge or jury wants to nail or jail, so the law can grow.⁶⁷

Charities, Endowments and Donor Intent: The Uniform Prudent Management of Institutional Funds Act, 41 Ga. L. Rev. 1277 (2007); Susan N. Gary, Revisions to the Uniform Management of Institutional Funds Act, Drafting Committee decisions made January 22, 2004, (not officially published).

⁶⁵ I believe the following story to be true. Many years ago a young lawyer went to work in the legal department of a large and adventurous foundation. He didn't understand that he had to develop a clientele within the charity. Program officers would bring him their projects and ask for his lawyer's blessing and he would say "no—you can't do that." Lawyers like to say "no" and justify it with "what-if" analysis. Eventually, program officers stopped coming to him for advice (his blessing, really) and he was a lawyer without clients instead of an attorney. He moved on.

⁶⁶ See John H. Langbein, Why Did Trust Law Become Statute Law in the United States?, Meador Lectures on Fiduciaries reprinted from 58 Ala. L. Rev. 1069 (2007).

⁶⁷ In the 1960s tenants rights lawyers waited for the perfect plaintiff – the saintly tenant suffering the neglect of a Dickensian landlord. Common law is good for an emerging standard. If my hypothetical saintly defendant has done something relatively harmless and totally explainable, and if a number of individuals with standing are not complaining or even supported the fiduciary, I can imagine a court saying, "We are not prepared to say that having given careful consideration to modern theories of investment and the desires of a number of current beneficiaries, that this trustee has actionably breached a duty to the trust. While we might have invested this fund differently"

I will make a wild guess and suggest that if there is such a suit that the law will change in favor of SRI.⁶⁸ In the abstract, that is a way we may get to a world where there is more flexibility in regard to SRI.

Forward looking charities coming to the attention of a state's attorney general may be able to negotiate with that attorney general and derive an administrative policy for charitable trusts that allows for some SRI investing in a jurisdiction. If that happens it could spread to other states. Or, a charity not under investigation could initiate negotiations with a progressive attorney general.

In lieu of litigation, I believe we need to know what SRI investors are doing and the world needs to be told. We need facts facts facts. The only way to know what SRI investors are doing, so that our picture of "prudent SRI investing" can evolve without litigation, is for accounts and studies to emerge. Lawyers are snobs; lawyers love facts. Fact-rich, SRI tales redolent with accounts of big numbers and big banks can have a very positive effect. Perhaps a business reporter of repute and ability will author a book or a report for a foundation that is credible and that dehorns SRI.⁶⁹

4. Switching gears, there's room to argue that the whole question of SRI may become moot. How so? The basic premise of SRI efforts involving other people's money is that fiduciary owners of publicly traded equity securities can be convinced to expand their fiduciary

⁶⁸ What if a Catholic priest as grantor establishes a trust for his Catholic family and the trust is silent and the trustee invests in an Ave Maria Catholic values mutual fund or funds and the return is not satisfactory to a plaintiff with standing? I would guess a law suit by a disgruntled beneficiary would not succeed even if the return was less than that of a similar unconstrained fund (the return being less either because of the constraints or the transaction costs). Would it be implied beneficiary remission of duties, or implied intent of the settlor? And add what if, what if, what if? If only the trustee feels the need to invest in Ave Maria for his own sake that is disloyal. See generally, the last section of this essay about possibilities for the future. Ave Maria Fund information can be found at www.avemariafund.com. The Ave Maria Fund takes advice from Phyllis Schafly and Tom Monaghan. The social indexing organization, KLD Research & Analytics has a Catholic Values index. See KLD Launches the KLD Catholic Values 400 Index (2007), <http://cts.vresp.com/c/?KLDResearchAnalytics/12fce00874/ddf5047b6d/04ea156fe0>
All screens have a cost.

⁶⁹ But see Joe Nocera, Well Meaning But Misguided Stock Screen, N.Y. Times, Apr. 7, 2007, at C1. Similarly, a bibliography of close studies of profitable SR businesses that yield good returns might comfort some fiduciary investors, as would a best seller on a poster child SR business.

investment duties, and by exhortation or shaming, be convinced to act as socially responsible investors.

One might argue that changes in the world of investing suggest that this model is flawed for future use.

Putting it differently, I wonder if SRI is less relevant than ever. How so? My sense is that institutional investing is changing so much that even as more assets come under SRI management, the institutional investors are doing things that make SRI irrelevant, that make it hard to think about and apply SRI. Oversimplifying, I am suggesting that hedge funds and private equity have nothing to do with the current model of SRI. If hedge funds and PE are in another galaxy from SRI then as Mr. HEDGE and Ms. PE become more important than SRI becomes less relevant. I am having trouble imagining how an SRI advocate attacks Mr. HEDGE and Ms. PE except as tools from the Devil's workshop (which is what some of them are doing).⁷⁰ It's all in French for the typical SRI guy when it comes to fighting Demons HEDGE and PE. The basic attack becomes, "Stop Using the Devil's tools for the Lord's work." And I fear that may be boring.

Expanding on my point, I suggest we are witnessing what might be called (oversimplifying) the de-equitization of the market. What does that mean? Several things. Most important, there is less classic equity out there to be responsible about. De-equitization as I am using the term is a mix of public companies going private⁷¹ (i.e., corporations are selling themselves to private equity⁷² investors who

⁷⁰ In the summer of 2007 one has to wonder how long alternate investments of the sorts discussed in the text will remain front and center.

⁷¹ Briefing: Public v private equity; The business of making money, *The Economist*, July 7, 2007, at 68 ("Life is no longer much fun in a publicly quoted company. Executives have to suffer the slings and arrows of intrusive media coverage, the oppressive tedium of "box-ticking" corporate-governance codes, the threats of activist investors and short sellers, and the scrutiny of single-minded political campaigners....Public companies have to reveal a lot more than private ones. Pressure groups can pore over every detail of company policy from the use of child labour to carbon emissions. Ibid at 69."). Decreasing liquidity in the summer of 2007 may signal changes in private equity investing.

⁷² There is said to be something called private equity in SRI investing but returns are said to be ten percent short of "regular" private equity investing and I am tempted to guess it's just close corporation do-good investing. Corporations are also buying back their own securities which reduces the amount of equity in public hands. It's possible that private equity's day has come and gone. See James Politi & Francesco Guerrera, Not dancing anymore: how the music stopped for buy-out buccaneers, *Fin. Times* Aug 14, 2007, at 7. Efforts to open up the process have been at least partially successful--as when the San Jose Mercury News and others sued California public

do not have to disclose their activities at this time and in this place), ownership remaining public but consolidating, sales of publicly traded equity⁷³ (and, more important) sales of private equity⁷⁴ taking place on private markets, outside public purview,⁷⁵ sophisticated investors of the sort SRI advocates are always lobbying being attracted to derivative investments that don't lend themselves to SRI analysis,⁷⁶ and a small, but growing, movement to fund pension obligations with bonds not stock (so-called asset-liability matching—matching pension liabilities to a bond portfolio).⁷⁷ Bonds (debt) are boring and the holding of bonds does not lend itself to SRI campaigning (“student rally at noon to protest the university’s buying short term commercial paper in the secondary market of a company accused of polluting” doesn’t quite do it). And, derivatives that are classified as debt can be given equity like characteristics so that one can have ones cake and

pension funds to reveal fund management fees. See

<http://72.14.253.104/search?q=s+private+equity+public+records&hl=en&ct=clnk&cd=2&gl=us> as one example. If reputation of public figures can be undermined then the complexity of their finance dealings need not be told. See

<http://www.washingtonpost.com/wp-dyn/content/article/2007/05/10/AR2007051002277.html>

⁷³ I am referring to so called big boy letters often used when insiders sell to sophisticated investors who sign a letter waiving their rights to claim wrongdoing because the seller is an insider and knows more. The seller is ignoring the information asymmetry and saying, in essence, “I am a big boy. I can take the pain. I know what I’m doing.”

⁷⁴ “Private equity is a heavily geared ‘long only’ investment in illiquid assets (whole companies), with high levels of control and a multi-year time horizon.” The Lex Column, Relative values, Fin. Times, July 9, 2007, at 14. John Plender, Private equity cannot escape the public eye, Fin. Times (April 24, 2007) (“[L]arge chunks of the global corporate sector are becoming less transparent. In jurisdictions such as the US, where there is no requirement for private companies to make accounts publicly available, much information about business activity is disappearing into a black hole.”)

⁷⁵ Goldman Sachs has established a private stock exchange where holders of large stakes in private equity can sell to entities that want to be holders of large stakes in private equity. Hedge Fund A can sell to Hedge Fund B without having to sell over the counter, A to B in a private transaction. Timothy Taylor, Recommendations for Further Reading, 21 J. of Econ. Perspectives 239, 240 (2007) (“Private equity firms, almost non-existent in 1980, sponsored more than \$200 billion of capital commitments last year alone.” Taylor also notes that “5% of the value of global initial public offerings was raised in the U.S. last year, compared to 50% in 2000.” Id.) See also Private stockmarkets: Hail the hybrids, The Economist pg 86 (June 9, 2007) (“Another [attraction of private equity] is the possibility of raising capital while avoiding the less desirable trappings of full public ownership, such as class-action litigation, compliance with the Sarbanes Oxley law on corporate governance, and pressure to make quarterly numbers.” And one might add pressure from SRI investors.). Goldman has also established a small SRI unit.

⁷⁶ Gillian Tett & Paul J. Davies, Unbound, How a market storm has seen derivatives eclipse corporate bonds, Fin. Times, August 8, 2007, at 7. Derivatives are well explained in Satyajit Das, Traders, Guns & Money: Knowns and unknowns in the dazzling world of derivatives (2006).

⁷⁷ The inventor, or rediscoverer, of this idea is John Ralfe the actuary for the Boots pharmacy pension plan in England and who got a lot of attention for selling all equities in the plan and substituting bonds. See www.johnralfe.com/.

eat it, too. Such derivatives would be hidden behind two curtains: (1) complexity and (2) “We’re debt, we’re boring.”

Additionally, synthetic/virtual/derivative investments theoretically allow the replication of the risk and return profiles of socially unwholesome assets and portfolios without actually owning the unwanted assets.⁷⁸ Although this is not happening in 2007, as a matter of purposeful SRI, as far as I know, it is quite possible and could sound the death knell of negative (or exclusion) SRI. This will end shaming by direct exclusion and not starve evildoers of capital.⁷⁹

So, there is less public equity now. Sophisticated investors are buying other things besides shares of public companies, and less of that public equity is held by pension trustees. The defined benefit pension plan is a dying beast, such trustees often buy alternative investments and many SRI investing pleas are aimed at such trustee funds. As self directed defined contribution pension plans take over it will be the pensioner herself who does or doesn’t choose the SRI investment.⁸⁰ Trying to convince trustees of defined benefit pension plans to engage in SRI will become a dying trade.

⁷⁸ John Cassidy, *The World of Business*, Hedge Clipping, *New Yorker*, July 2, 2007, http://www.newyorker.com/reporting/2007/07/02/070702fa_fact_cassidy, (Cass Business School Professor Harry Kat questions why anyone would pay hedge-fund fees); Eleanor Laise, *The Hedge-Fund Clones*, *Wall St. J.*, July 21-22, 2007 at B1. Similarly, the ease with which equity exposure can be converted to debt like instruments makes the tracing of clean and unclean investments by marching students all the harder. See Mohamed El-Erian, *How to reduce risk in the financial system*, *Fin. Times*, July 10, 2007, at 11. Ditto the transfer of the risk traditionally associated with traceable equity or junk bonds, which are understood to have equity like characteristics. Complexity is management’s friend when avoiding SRI demands is concerned. Cf., John Plender, *There can be no return to ‘normality’ of a freakish bubble*, *Fin. Times*, Aug. 30, 2007, at 22 (“A peculiar feature of this 21st century financial crisis is its opacity—nobody knows where risk has ended up.”). Replicant hedge funds are also discussed in Jasmina Hasanhodzic & Andrew W. Lo, *Can Hedge-Fund Returns Be Replicated?: The Linear Case*, 5 *J. Investment Mgt.* 2 (2007); Steve Johnson, *The sector that arrived late to the party*, *Fin. Times* 6, July 31, 2007.

⁷⁹ See Julie Hudson, *The Social Responsibility of the Investment Profession* (a research foundation of [the] CFA Institute monograph). www.cfopubs.org. 83 (2007); Michael S. Knoll, *Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment*, 57 *Bus. Law.* 681 (2002).

⁸⁰ Samuel Estreicher & Laurence Gold, *The Shift From Defined Benefit Plans to Defined Contribution Plans*, 11 *Lewis & Clark L. Rev.* 331 (2007); David Wighton, *Wall St Despatch*, *Pensions worry CEOs*, *Corporate Finance (Special Report)*, July 25, 2007, at 3.

So, it could be argued that SRI is based on a model that is, at best, volatile and, at worst, also a dying beast.⁸¹

And, if I may, it seems to me that the PR efforts, proxy battles and shareholder motions seeking socially just corporate action are more efficient ways of changing corporate behavior than selling or refusing to buy the shares of offending corporations⁸² or even engaging in more sophisticated SRI activities.⁸³ I think it's no accident that these days major pension funds seek to convince major corporations to stop doing business in a place like Iran, rather than to threaten to sell the stock.⁸⁴ The traditional tools of SRI are weak devices for affecting corporate change when compared to the semi-strong tool of shareholder resolutions and the stronger tool of bad public relations.

5. Even if pension trustees will listen to SRI pleas the pressure on pension fund trustees to earn every last dime will impede the acceptance of SRI. Constrained portfolios are second best. The universe is diminished. There are fewer opportunities. Diversification might be affected. Even pro SRI pension trustees are very hungry for return and some of them are concluding that SRI constrained portfolios are called constrained for a reason – they're constraining return.⁸⁵

⁸¹ If the topic is beasts, I cite Tony Jackson, Monsters are trampling the divisions set up to protect all, Fin. Times, July 16, 2007, at 21 ("Other financial institutions are becoming monsters, as well."). Monsters are not swayed by SRI arguments.

⁸² I have concluded on casual reading that activists propose a scary annual meeting shareholder's resolution and then immediately withdraw it when management agrees to negotiate. Thus Marriott has agreed to train employees to spot exploited minor sex workers. See Melissa Stee, Churches Pressure Travel Industry on Sex Trafficking, Religious News Service, April 4, 2007. Engagement, activism and advocacy play an important role in SRI.

⁸³ Warren Buffett was asked to divest shares of PetroChina because of its activities in Sudan. He refused. Soon thereafter, he reduced his PetroChina holdings. Coincidence? You decide. Francesco Guerrera, Buffett cuts back PetroChina stake, Fin. Times 8 July 28, 2007. KLD offers a Sudan compliance product.

<http://cts.vresp.com/c/?KLDResearchAnalytics/4fdb0f2894/aad879481a/ba5e70c49a>. And there is a reform Sudan ETF. See G. Jeffrey MacDonald, More ETFs aim to please the socially minded Two new exchange traded funds are geared toward alternative energy firms and pressuring for reform in Sudan, <http://www.csmonitor.com/2007/0723/p13s01-wmgn.html> (July 23, 2007).

⁸⁴ Tim Martin, Divestment Efforts Take Root, Davis Enterprise, July 25, 2007, at 1 (Pension funds lean on Shell to get out of Iran, rather than threaten to sell Shell shares.).

⁸⁵ See Gilbert Chan, CalPERS To Ease up on Social Activist Role, Sac. Bee, June 19, 2007, at 1; Gilbert Chan, CalSTRS rethinks tobacco investment ban, Sac. Bee, Sept. 6, 2007, at D1. Cf. Tony Jackson, On Monday: Perfect recipe for swings between greed and fear, Fin. Times July 9, 2007, at 19 ("For years, desperately low real yields have pushed institutions such as pension funds ... into risky assets, as a means of fulfilling rash promises to pensioners ..."). Interestingly, the competition for poorly run companies is fierce. Oh what is an investor to do? Sell them short?

6. SRI will get better.⁸⁶ SRI folks will continue to close the risk adjusted return gap between what SRI can do and what pure financial investing can do. To the extent that is not possible, they will make better arguments about why their goals are more important than making money.⁸⁷ Public attitudes will change.

7. More and more aspects of the nonprofit process will be quantified and subjected to metrics. Metrification, if you will, will be the order of the day. That is the world of the modern non-SRI investor. And in the broader world of nonprofits we see charitable donation advisers, and we know that sophisticated foundations seek to quantitatively know the impact and efficiency of their grants. I expect the further

Buy them because private equity will pay you a premium because the PE lads want to take the poorly run operation private and fire everyone, clean up the balance sheet, and take it public again and make a lot of money? Or buy them because corporate activists will buy them and clean them up without taking them out of the public arena and the price will rise? One might argue that only the terminally ill corporations should be sold short for fear the price will rise when the lemonade makers discover the short seller's lemon. For the proposition that it will be harder for private equity types to make money buying and cleaning up lackluster corporations see, Jeremy Grantham, After the calm, private equity must now brace for the storm, Fin. Times 20, August 22, 2007 (Hot hands cool down, it's natural law).

Another interesting point goes like this. It is said that SRI campaigns are attempts at pseudo-state governance or regulation of corporations. See John H. Langbein, Social Investing of Pension Funds and University Endowments: Unprincipled, Futile, and Illegal, in *Disinvestment: Is it Legal? Is it Moral? Is it Productive?*, An Analysis of Politicizing Investment Decisions 1 (John Langbein et al. eds., 1985). It was said in 2007 by a learned commentator that misbegotten, targeted attempts to regulate derivatives can lead to the undoing of our global financial system. See Mohamed El-Erian, How to reduce risk in the financial system, Fin. Times, July 10, 2007, at 11. It was further implied that all such regulation is inevitably incompetent, especially when it is politically motivated (which SRI arguably is). So, one might argue that SRI, insofar as it properly labeled pseudo-regulation, runs the risk of bringing down the whole financial system. For a hybrid over governance and SRI, see Phil Angelides, Born in Sacramento: The 'Green Wave' of Clean Environmental Investing Began Here, Sac. News Rev., Aug. 16, 2007, at 27 (former elected official claims to have taken up SRI early in the game).

⁸⁶ See Rob Bauer, Kees Koedijk & Roger Otten, International Evidence on Ethical Mutual Fund Performance and Investment Style, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=297882 at 13 (2002). Professor Bauer is a frequent writer on SRI.

⁸⁷ For the most part, people who do money well don't do SRI. If they do do it they segregate in special units or limit the involvement either to indices or to very traditional exclusions (tobacco, alcohol, arms) which are easy to do and which do not dramatically reduce opportunity or diversification.

If SRI becomes more common it will surely represent an opportunity for nonSRI investors to profit. The more common SRI becomes the more the prices of SRI shares will be bid up (and the lower that shares of non SRIs will fall) and the greater the relative return will be on the non-SRIs (chiefly because their dividends will be higher than on SRIs and will contribute meaningfully to total return, even as the dividend return on SRI stocks decreases). One would want the capital gain from the newly wanted SRI stocks and the dividends (and put income) from the unloved nonSRI stocks.

metrification of SRI. To me this is an extension of the world of hybrid investing and fourth sector notions.⁸⁸ The importing of VC and PE ways of doing things into the world of charity is one more example of shining a quantitative, MBA light on things.

8. Points of view that have been labeled hortatory law may well become normative or prescriptive. I have in mind “expressive law” and “constitutive law.” Expressive law is law that is meant to do more than regulate conduct and behavior. It is also meant to make express ideas about law and change values.⁸⁹

Proponents of Constitutive law would tell us that one cannot act one way and be something else—that a “good” nonprofit cannot make bad investments and remain good.⁹⁰ For instance, mission and investments must be harmonious; there must be harmony at the inner core.⁹¹ This applies to personnel and to institutions. The law of fiduciary investing will take these arguments into account. At the moment these arguments go unheard in law offices, but their day may well come. In any event these bodies of thought will be brought to bear, to one degree or another. SRI seeds will be sown on the rocky soil of fiduciary investing and will take at least shallow root.

9. New ideas will be brought forth. Old ideas will be rephrased in new ways that are, or seem to be, more respectable in the halls of modern finance. Money will be made, and lost.

SOME THINGS NEVER CHANGE.

1. Every investor who has an SRI cast of mind, and who owns imperfect assets, still must choose between exit and voice when

⁸⁸ See ___ infra.

⁸⁹ Holly Doremus, *Constitutive Law and Environmental Policy*, 22 *Stan. Envtl. L.J.* 295, 311 (2003) (“law does more than directly regulate conduct. It also, and inevitably, conveys endorsement or rejection not just of the conduct regulated but also of the values that inform that conduct. The messages law sends ... can be as important as its direct regulatory power.”); Jane B. Baron, *The Expressive Transparency of Property*, 102 *Colum. L. Rev.* 208 (2002).

⁹⁰ See, e.g., Holly Doremus, *Constitutive Law and Environmental Policy*, 22 *Stan. Envtl. L.J.* 295 (2003).

⁹¹ See, e.g., Holly Doremus, *Constitutive Law and Environmental Policy*, 22 *Stan. Envtl. L.J.* 295 (2003). A constitutive perspective calls for a nonprofit to choose investments consistent with its values. *Ibid.* 318. Apologies to those who give these ideas more weight than this article gives them.

corporate management is doing something unattractive. SRI investors still must face the question of which is better for society. To exit, and vote with your feet, to sell the stock, probably has less impact than to socially vote proxies or to offer an outrageous shareholder's motion and then withdraw it and negotiate with management or to campaign in some other fashion for a change in corporate conduct. The next buyer of the shares won't care about the exit⁹² and it seems unlikely the cost of capital for the divested corporation will go up (that being the SRI financial justification for the divestment),⁹³ although there may be a public relations justification for a noisy sale – to generate bad press for the “villainous” corporation whose stock is sold.⁹⁴

2. Dirty money still remains the bane of every charity's existence. If it isn't soliciting donations from some wicked capitalist it's earning the best return via sin stocks⁹⁵ or getting research grants from sin stock companies.⁹⁶

3. SRI is still primarily about OPM – other people's money in capital pools. I've never been asked by a human being to put my own money

⁹² Michael S. Knoll, *Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment*, 57 *Bus. Law.* 681 (2002).

⁹³ Julie Hudson, *The Research Foundation of CFA Institute Publications, The Social Responsibility of the Investment Profession* (2006); Michael S. Knoll, *Ethical Screening in Modern Financial Markets: The Conflicting Claims Underlying Socially Responsible Investment*, 57 *Bus. Law.* 681 (2002).

⁹⁴ As a young man I thought voice was the equivalent of staying a member of a restricted country club. I am trying to change them from the inside. As a not young man I no longer think that. It is to be noted the Yale handbook on how to manage Yale's investments ethically takes the position that it's not the university's job to support publicity campaigns against corporate miscreants even if they have divested ownership of that corporation's stock. See John G. Simon, Charles W. Powers & Jon P. Gennemann, *The Ethical Investor: Universities and Corporate Responsibility* (1972).

⁹⁵ The point was put by George Bernard Shaw as quoted in John G. Simon, Charles W. Powers & Jon P. Gennemann, *The Ethical Investor: Universities and Corporate Responsibility* 26 (1972). As they put it: “George Bernard Shaw's point of view reflected in his comment on the clergyman who would accept money only from sweet old ladies: ‘He has only to follow up the income of the sweet ladies to its industrial source, and there he will find Mrs. Warren's profession and the poisonous canned meat and all the rest of it. His own stipend has the same root. He must either share the world's guilt or go to another planet.’ Too many people, however, let the matter rest here: because one cannot avoid contamination, one cannot do anything at all.” I put the point less elegantly in Joel C. Dobris, *Arguments in Favor of Fiduciary Divestment of "South African" Securities*, 65 *Neb. L. Rev.* 209, 224 (1986). (“If I have a bad knee and a bad back it is absurd to say that since I will not fix the back, there is no purpose to fixing the knee.”).

⁹⁶ *Ban Up in Smoke*, *Stanford Mag.* (July/August 2007), at 22 (“Stanford researchers remain free to accept funding from any source”).

into an SRI fund and I don't have any memory of getting SRI solicitations by mail or email.⁹⁷ But there are always folks wanting the funds backing my pension invested in SRI investments. I suppose that may change in the future.

IF I WERE AN SRI GUY.⁹⁸

1. I'd want to get out the story of the current state of affairs in the world of SRI investing. I think a lot of people are mentally stuck in the 1980s and assume that a small amount of money is being badly mismanaged under the (leaky) SRI umbrella. As long as most investors want to fail conventionally⁹⁹ get the word out that, "We're conventional." Make SRI a boring conventional thing to do.

Drive into the popular imagination the seemingly large size of the pool of funds under SRI management and the commitment of major financial operations like UBS to the SRI market. Nothing, except perhaps a pin striped suit and a two hundred dollar tie,¹⁰⁰ impresses trusts and estates, and nonprofit lawyers and money managers as much as big numbers.¹⁰¹

To the extent major banks like UBS are selling SRI try to tap into their sales force to make the point.

2. Try to meet quant¹⁰² arguments as well as can be done. But then stop pretending, when the conversation is an informed one. Stop

⁹⁷ I have friends at another school in a left leaning department where salespeople come calling. I believe there was a meeting where SRI investments for 403(b) were touted and I believe sold in what was a successful camp meeting type sign up of investors. I would imagine it was hard not to buy in that context. One of my colleagues who read this piece tells me he has.

⁹⁸ "If I Were a Carpenter, and You Were a Lady" Bobby Darren, If I Were a Carpenter, on If I Were a Carpenter (Edsel Records UK 2007).

⁹⁹ John Maynard Keynes, *The General Theory of Employment, Interest and Money*, 158 (1936).

¹⁰⁰ Peter Gumbel, London vs. New York Smackdown, *Fortune*, Aug. 6, 2007, at 36, 39; *Observer*, Do clothes make the bank? *Fin. Times*, Aug. 14, 2007, at 10.

¹⁰¹ In the summer of 2007 much was being made of the idea that agents wear suits and principals wear what they want. Felecia Williams-Scott, Casual attire can still be powerful, *The Times* (Shreveport, Louisiana)(July 12, 2007) (Lexis/Nexis).

¹⁰² As used in the article the word quant (or quants) means an "expert in quantitative analysis" or if you prefer "An expert in the use of mathematics and related subjects, particularly in investment management and stock trading" or "A person who has strong skills in mathematics, engineering, or computer science, and who applies those skills to the securities business. For example, a pension fund may employ a quant to put together an optimal portfolio of bonds to meet the fund's future liabilities. Also called rocket scientist." I would say the likeliest expertise is in statistics or

citing return history without discussing risk. Stop pretending that absolute return exists independent of risk. Have an answer to negative arguments against SRI, e.g., that SRI and currently successful styles have simply overlapped for a moment in time and that is the reason for SRI's apparent success. Stop chanting slogans. It's not Saturday night at a faculty dinner party. Stop saying SRI is as good as MPT/CAPM when it comes to making money. It's not. It's second best. It may be OK to say it's best to customers and true believers but it's not going to convince quants.¹⁰³

3. Encourage intrepid trustees to act as SRI investors and see if they get sued.

4. Fund research on using derivatives to replicate the return of tainted portfolios or securities if the conclusion is that there's no return as good as the return on dirty money.

5. Fight hard for the transparency of the investments of private equity and hedge funds.¹⁰⁴ Black box investing is bad for SRI because so

computer simulations. See Gillian Tett, Crunch time: when the computer gets it wrong, Fin. Times, Sept. 1/2, 2007, at Life & Arts 1.

It's business slang. See <http://dictionary.reference.com/browse/quant>. Oversimplifying, it's someone who looks at the numbers and the theories and not at the story. Someone with a preference for numbers and whatever particular statistical or computer technique that makes sense to him or her. Hard guys. Someone who, when investing, is bloodless, indifferent to human considerations. A friend of mine defines it thusly, "A quant is someone who bases investment decisions on mathematical algorithms rather than on traditional research techniques such as company visits, management interviews, etc." Or, if you prefer, I quote Peter Bernstein from an interview, "Professional investing has become much more quantitative and much less based on gut." In The Vanguard 1, Summer 2007. Again, this is a simplification.

I believe there is another definition – someone who runs a so-called quant fund that is based on computer trading. I do not use the word in that sense. I also do not use the word to describe "quantitative hedge funds, or quants, which use computers to make trades based on mathematical equations". Anuj Gangahar & Peter Smith, Quants 'victims' of own success, <http://www.ft.com/cms/s/a8b9f7a8-4cff-11dc-a51d-0000779fd2ac.html> (Aug. 17, 2007). The meaning of the word is always up for grabs. See Emanuel Derman's review of Richard R. Lindsey & Barry Schacter's book, How I Became a Quant in the Wall Street Journal of August 22, 2007 at D10. Mr. Derman is the author of My Life as a Quant (2004).

¹⁰³ An SRI advocate might want quants on board because it will reduce opposition to fiduciaries investing in SRI portfolios. Similar arguments to those made in this paragraph can be found in Thomas W. Joo, Race, Corporations and Shareholder Value, 54 J. Legal Ed. 351, 360-64 (2004).

¹⁰⁴ Although hedge funds bring to mind rapacious investing done without regard to social values there is no reason why hedgers cannot be social responsible. See Simon Hildrey, Taking responsibility, http://www.ftmandate.com/news/fullstory.php/aid/710/Taking_responsibility_.html (refers to an SRI fund of [hedge] funds. It is said that there are five SRI hedge funds.)

many SRI tactics are based on shame and blame. It's hard to demonize a hedge fund fund of funds that invests in a portfolio of CDOs backed by asset-backed securities and synthetic CDOs with counter party risk taken up by the Kingdom of Denmark and a Houston-based hedge fund rumored to be backed by someone who used to work for the Bass Family.¹⁰⁵ The unions and some politicians understand this.¹⁰⁶

6. Understand that one of the things SRI folks are doing is calling for the recognition of principles of expressive¹⁰⁷ and constitutive law. Encourage someone to write a fancy article on such versions of hortatory law as they affect SRI. Exploring expressive and constitutive law and their relationship to and effect on SRI is likely to advance the SRI cause.

7. Understand in that context, and more generally, that there is a generation of young law professors that is economically literate and that is also literate in hortatory law and that is not necessarily obdurate about SRI investing, especially if approached from an environmental, social, and [corporate] governance (ESG) point of view.¹⁰⁸ This is a growing audience of non-dismissible folks, that will at least listen respectfully to the semi-strong claims of SRI. They are

¹⁰⁵ Cf. Rene M. Stulz, *Hedge Funds: Past, Present, and Future*, 21 *J. of Econ. Perspectives* 175, 176 (2007) ("Mass selling of hedge fund strategies is much harder because hedge fund strategies are too complex for the typical mutual fund investor to understand."); Richard Beales & Gillian Tett, *Real Risks emerge when Pandora's investment box is opened*, *Fin. Times*, June 29, 2007, at 23; Stacy-Marie Ishmael, *Jargon Busting: A PIK of the ABCD's of arcane credit derivative terminology*, *Fin. Times*, June 29, 2007, at 23. See also Michael Kaplan, *A game of bluff and bluster for extravagant reward*, *Fin. Times*, Jul. 2, 2007 at 11 ("Private equity is different. Its very secrecy carries us away"). As I wrote *supra*, Complexity is management's friend when avoiding SRI complaints is concerned. There's an emerging view that dividend derivatives constitute their own asset class. Masking an S & P 500 investment in such a derivative might put some SRI hounds off the trail. Or, given that such derivatives are custom made how much extra effort would it take to drop the dividend from the tobacco company that uses child laborers addicted to alcohol? In the same vein, such derivatives are often written around single stocks so it becomes "trivial" to avoid my fake tobacco company. See Chris Hughes, *General Financial: Dividends – the accidental asset class*, *Fin. Times*, July 12, 2007, at 15.

¹⁰⁶ Observer, *Crocodile tears for private equity titans*, *Fin. Times*, Aug. 30, 2007, at 8; *Private equity, Walker's way*, *The Economist* 73 (July 21, 2007).

¹⁰⁷ Holly Doremus, *Constitutive Law and Environmental Policy*, 22 *Stan. Env'tl. L.J.* 295, 311 (2003).

¹⁰⁸ For a discussion of ESG standards see Freshfields Bruckhaus Deringer, *A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment* (United Nations Environmental Programme Finance Initiative 2005).

not deaf to such claims.¹⁰⁹ There is a generation gap here—not all law professors who are open to SRI majored in sociology.¹¹⁰ Recognize it and work it. There’s potential for forward motion here. There are some folks out there waiting to meet you.

8. Let’s talk about transaction costs.

Step up to the plate and deal with the argument that SRI is, at best, too expensive. I.e., even if screening for best ESG governance, to take an example, worked as a technique for obtaining alpha¹¹¹ the screening cost is awfully high.¹¹² And, in a similar vein, can I the trustee, justify purging the large and highly oil stocks from my trust, thereby losing (say) 10% of the trust's capital to capital gains taxes, in order to make the beneficiaries happy and try for a higher return?

Make the case for incurring high transaction costs in pursuit of justice and/or find ways around those costs.

Get funding for absorbing the cost of high transaction costs incurred in the pursuit of justice.¹¹³ Found and fund something one might call The SRI Fund for the Future that might make distributions to entities that incur excess transaction costs in pursuit of SRI justice.¹¹⁴

Alternatively, find funding for research into an SRI method that yields risk and gross return figures equivalent to a non-SRI portfolio and then work on getting the transaction costs down, or, as stated, moving the transaction costs over to a nonprofit or low profit entity.

9. Get someone to write up the best modern case for SRI aimed at lawyers and trustees with spine. The aim should be to produce a brief that allows lawyers to opine that SRI is a legitimate activity and puts

¹⁰⁹ Quants love to be dismissive. See Daniel Gross, Fifteen Dollars’ Worth of Smug <http://slate.com/id/2170561/> (July 17, 2007).

¹¹⁰ Apologies.

¹¹¹ Alpha is the return achieved in excess of a benchmark return, after adjusting for any additional risk taken to achieve the return.

¹¹² See Joe Nocera, Well Meaning But Misguided Stock Screen, N.Y. Times, Apr. 7, 2007, at C1.

¹¹³ My colleague Tom Joo suggests considering seeking a tax credit.

¹¹⁴ Transaction costs may be going down. There are bound to be economies of scale. And one is tempted to say that the internet makes research cheaper. The dream would be returns equivalent to non-SRI returns obtained with transactions costs that were minimally larger than non-SRI transaction costs.

such folks in a defensible position if they are sued for engaging in SRI or for malpractice in blessing SRI.

10. In the same vein, encourage a credible law firm to set up as special counsel to opine as to the propriety of various social investments in various social contexts. Spine-endowed trustees could seek the opinion of such competent special counsel when it came to SRI matters.

In the same vein, encourage that lawyer or firm to constantly publish in support of SRI.¹¹⁵

11. Fuss about the Einer Elhauge point which is, I believe, that corporations have wiggle room to do good, that there really is no duty to profit maximize to the last dime in the corporate world, that corporate fiduciaries actually have some profit sacrificing discretion.¹¹⁶ Then argue that if what Elhauge says is so, then why not say the same about nonprofits, and to the extent it can be said, about trusts?¹¹⁷ Taking Elhauge as gospel, one might argue from his paper that historically corporations have been controlled by people who had a sense of duty to society and who “felt the burn” of any social impositions they would impose by rapacious profit maximization. The urge to profit maximize was internalized. So, the Bush family steel mill corporation gave corporate funds to charity in the name of the corporation, sponsored Bushville’s July Fourth fireworks, etc. The corporation let a little profit leak away for the home team, society got a free ride and only a very few corporate captains sought to earn the last corporate dime.¹¹⁸ We were free to worship

¹¹⁵ One could imagine a law professor playing a similar role.

¹¹⁶ One is tempted to tell the tale of Anita Roddick, the founder of the Body Shop, famed for its ethical business practices and General Electric’s Ecoimagination program. See Adam Jones, A Trojan Horse let loose inside the walls of L’Oreal, *Fin. Times*, Sept. 12, 2007, at 22.

¹¹⁷ Einer R. Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 *N.Y.U.L. Rev.* 733 (2005). For one thing trust beneficiaries are more sentimentally appealing than corporate stakeholders. Widows and orphans, 80 year old pensioners. They deserve special consideration. While corporate fiduciaries may (or may not) have profit sacrificing discretion, trustees do not. One might commission a business historian to Brandeis Brief the case for Elhauge’s point.

¹¹⁸ And those that did get pilloried in the movies. See *It’s a Wonderful Life*, (Liberty Films (II) 1946). See generally Irene Lynch Fannon, *The Corporate Social Responsibility Movement and Law’s Empire: Is There a Conflict?* 58 *N. Ireland Legal Quarterly* 1 (2007). To the extent I am correct in this regard, the current (2007) pattern of selling family businesses is arguably

and adore a capitalist system under which we did not live—we were free (like boys in a schoolyard) to say we were something we were not -- total profit maximizers. Those who controlled corporations did take social needs into account. They did “breach their duties” to shareholders every day. Managers considered social and moral norms all the time whether we admitted it or not. When they stopped doing that, when they became profit maximizers, in fact, then commentators and some courts, in dictum, said that profit maximization was required, even though it really wasn’t historically and arguably isn’t today. Corporations historically did sacrifice corporate profits all the time, although it is done less today.¹¹⁹

Assuming the Elhauge argument is accepted, then one might argue that it’s not a big leap to move it over to the nonprofit corporations arena. Indeed, it’s almost what you’d expect of nonprofit managers.

One could argue that society is entitled to it’s leakage of profit for social good even if it is an inefficient way to get money spent on social good.¹²⁰ That is SRI investing by foundations and nonprofits is good for society even when it doesn’t profit maximize.

Putting it another way, to the extent that recent efficiencies in corporate management have led to our losing the modest leakage of the last dime of profit to charity, how about redeeming that lost

unfortunate. See Francesco Guerrera, *Out of the picture; Why many of America’s big family businesses are looking to sell up*, *Fin. Times*, July 23, 2007, at 5.

¹¹⁹ The points made in this paragraph are considered in Thomas W. Joo, 79 *St. John’s L. Rev.* 955 (2005). See also *Kahn v. Sullivan*, 594 A. 2d 48 (1991). In their own context Jonathan Klick and Robert Sitkoff point out Posner’s observation that “‘neither the trustees nor the staff’ of a charitable entity has a ‘strong incentive to maximize value’” citing Richard A. Posner, *Economic Analysis of Law* § 18.5, at 547 (7th ed. 2007). See Jonathan Klick & Robert H. Sitkoff *Agency Costs, Charitable Trusts, and Corporate Control: Evidence From Hershey’s Kiss-Off* 24 (forthcoming). One might argue, in the context of nonprofit endowment investing, that if this is the order of the day for charities, in fact, why not extend that attitude to SRI. Isn’t it a bit silly to cabin off endowment investing in the midst of all this unpunished lackadaisicality? Indeed, profit or nonprofit, so many mistakes are made, so many agency costs are paid without anyone being successfully sued, why are poor old nonprofits always told they can’t engage in social investing? T’ain’t fair.

Put another way, can it be in this new world heralding the wisdom of crowds, celebrating behavioral finance, and giving us financial failure of experts in the summer of 2007, that the growing number of fans of SRI know something that many readers of this article have been missing?

¹²⁰ Child labor may be efficient and profitable but we don’t allow it. Brothels in Nevada may be very profitable but we don’t require trustees to invest in them. We’ll trade a little inefficiency for social good. There are limits on corporate valuiism.

leakage via SRI? Can it not be said that that SRI is the 21st century version of the family corporation paying for the July 4th fireworks in the park? We're entitled to our leaks. And, the truth be told it's all about second best systems in any event and one might argue that not much point in arguing about which second best solution is better, at least not at the margins.¹²¹

Putting it a little bit differently, if business corporations can sacrifice a bit of profit why can't nonprofit corporations?¹²²

This may work for nonprofit corporations but it is less likely for trusts. There are, however, approaches that might bear fruit for private trusts, short of arguing that every trust has the right, if not the duty, to leak a little for society.

12. Preach to the middle. There's room for compromise on SRI. Find that compromise. I suspect it goes like this: a bit of SRI is OK for charitable endowments and for private trusts where a meaningful number of current beneficiaries request it.

13. Continue to press for enabling statutes that allow more SRI, recognizing that the organized law reform establishment is fairly conservative. Consider moving from the national stage to individual states where the legislature may be more receptive to change than the national law reform establishment.¹²³

14. Building on the preceding paragraph, see if a state can be induced to make SRI investing appropriate in silent instruments, perhaps, if

¹²¹ One might be prepared for the argument that such do good expenditures might be better made through increased taxes or charitable contributions.

¹²² 80 N.Y.U L. Rev. 733; Freshfields

http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf; Larry Mitchell advocated the same basic idea in the 1990s (before "norms" discourse was developed enough to make this all sound scientific). See Thomas W. Joo, 79 St. John's L. Rev. 955, 964 (2005) (citing Mitchell, Elhauge and Eisenberg).

¹²³ Consider weak legislation in one or more states. Get the camel's nose in the tent. An example is to be found in Manitoba: "In Manitoba, one of the Canadian provinces, trustee legislation and pension legislation state that non-financial considerations are not prohibited, so long as trustees and administrators still satisfy the requisite standard of care." OECD, 2007 OECD Roundtable on Corporate Responsibility, at 19, <http://www.oecd.org/dataoecd/3/0/38550550.pdf>.

need be, under a five percent de minimus exception, and then, speaking the unspeakable, hope that trustees consider the wisdom of changing the situs of their trusts to that state.¹²⁴ Speaking cynically, a state might do this to generate business for banks, bench and bar. In other words, try to establish a (compromise) five percent rule – that a fiduciary can invest 5% of her portfolio in SRI investments without meaningful further inquiry, so long as the investment decision and choice of assets are made in a dutiful manner.¹²⁵ Such a rule would offer efficiency in the time saved for judges, trustees and their lawyers.

15. Seek to encourage the creation of as quantitatively sound an SRI approach to investing as can be found. Get a quant to design the best SRI fund possible from a quant viewpoint. I.e., what would a starving quant who needed to put food on the table grudgingly do if he was given the job of coming up with the best SRI fund or screen or what-have-you? In other words, get a quant to design an African Queen for SRI – an inferior, second-best, vessel, but one that will get down the river and into the lake.¹²⁶

¹²⁴ See UTC § 202. Alaska strikes me as the state to approach. Similarly, there may be SRI virtue in the Alaska statute that creates an informal system for releasing a trustee from liability upon the termination of a trust by giving the beneficiary a window in time to complain and terminating his rights if he doesn't complain in a timely manner. See Alaska Stat. § 13.36.100. This offers some protection for the trustee who is willing to indulge in a bit of SRI if the change of situs is not, itself, a breach of fiduciary duty. If it's cheaper to run an Alaska trust than a northeast corridor trust then this savings in transaction costs might be claimed to offset increased transaction costs or return because of SRI activities. Cf. Manitoba: "In Manitoba, one of the Canadian provinces, trustee legislation and pension legislation state that non-financial considerations are not prohibited, so long as trustees and administrators still satisfy the requisite standard of care." OECD, 2007 OECD Roundtable on Corporate Responsibility, at 19, <http://www.oecd.org/dataoecd/3/0/38550550.pdf>.

¹²⁵ Joel Dobris, Why Five? The Strange, Magnetic, and Mesmerizing Affect of the Five Percent Unitrust and Spending Rate on Settlers, Their Advisers, and Retirees, 40 Real Prop. Prob. & Tr. J. 39 (2005-2006). Race to the bottom motives might inspire such legislation. See Robert H. Sitkoff & Max M. Schanzenbach, Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes, 115 Yale L.J. 356, 417 (2005) Stewart E. Sterk, Asset Protection Trusts: Trust Law's Race to the Bottom?, 85 Cornell L. Rev. 1035, 1060 & n.126 (2000).

¹²⁶ If you screen for nonfinancial reasons you will get a worse return or the risk will increase and ten million Monte Carlo simulations will prove that. Your claim is based on a sampling error. As to Monte Carlo simulations see Mark Kritzman, The Portable Financial Analyst 13-43 (2d ed. 2003). Prospectively, it seems likely that constrained returns that can be demonstrated for past periods will not be found in the future. As to the text see, The African Queen (Horizon Films 1951). Call it the African Queen, Second Best, SRI, Quant Fund of America.

16. Answer the questions: When is reducing return for SRI purposes not a breach of duty? When is not reducing risk, for SRI purposes, not a breach of duty?¹²⁷ Is it possible to quantify how much can be spent on transaction costs without there being a breach of duty? How much of that transaction cost amount can be allocated to SRI without breaching a duty? Is there a mechanical de minimus rule, or must the dead weight be born in pursuit of pecuniary profit?

18. Push LHI (Long Horizon Investing) investing and let others make the connection to SRI investing. There is an almost superstitious reverence for long term investing, a bred in the bone love of it.¹²⁸ And, I would submit that thinking about LHI automatically leads to thinking about SRI.¹²⁹

19. Get SRI arguments into the trusts and estates and the nonprofit corporations casebooks. Change the thinking of the next generation of lawyers by reaching today's law students.

¹²⁷ In early Summer of 2007 there was room to argue that while systemic risk seems to be at an all time low, by the end of the summer it was easy to argue that it is actually higher than ever. See Mohamed El-Erian, How to reduce risk in the financial system, *Fin. Times*, July 10, 2007, at 11.

¹²⁸ One of the supposed advantages of private equity investing is their long-termism. See Francesco Guerrera & James Politi, Moody's slams private equity, *Fin. Times*, July 9, 2007, at 15; The Lex Column, Relative values, *Fin. Times*, July 9, 2007, at 14 ("[Speaking of private equity] First, assets are tied up long-term. ... [KKR] says 73 per cent of its assets are committed for as much as 18 years. ... [I]t does give huge flexibility to ride out tough times.")

¹²⁹ David Swensen of Yale is said to be a fan of LHI. Tap into the reverence for LHI. Dance like a New England trust banker of yesteryear. Cf., John Authers's review of the book by Richard Bookstaber, *A Demon of Our Own Design* (2007), *Fin. Times* 10 (Aug. 10, 2007) ("By taking the simple approach rather than being too clever, the investment industry is more likely to avoid catastrophe, discovers John Authers"). Very long term investing of endowments and the like is considered astutely in James G. Garland, *The Fecundity of Endowments and Long-Duration Trusts*, 31 *J. of Portfolio M'gt* 44 (2005). See also Louis S. Auchincloss, *The Landmarker in Tales of Manhattan* 233 (1967) (story of a doyenne determined to wreck her landmark cast iron building in Soho, New York City, against the stated goals of a preservationist in her social circle. She commissions the demolition of the building and so the story ends. But we know he was likely right. Were she alive today her cast iron building would likely be worth more than whatever she built in its place, or so say I.).

LHI is "always" appropriate. For the 30 year old (obviously), for even the healthy 80 yr old (is an actuarial life exp of 8 yrs short?) and even for the terminally ill with a few weeks to live (you can't spend it but you're likely leaving it to someone with a long horizon). Horizon affects things like asset allocation (which has nothing directly to do with SRI). One should always be optimizing return vs. risk. LHI often suggests a large allocation to equity in a portfolio. See generally, David Salem, *Why Not 100% Stocks?*, http://www.tiff.org/TEF/articles/why_not_100_percent_stocks.html

20. Recognize that run of the mill lawyers are busy and distracted. Get form language allowing SRI investing out into the world so that a lawyer with an SRI client can adopt the form. Try to get promulgators of trust form books to include the language in their form books. Similarly, consider try to get the question “Do you want your trustee to have the power to make SRI investments?” into trust lawyers’ checklists. Of course, these suggestions could force anti-SRI sentiments out of clients and into their instruments, which would defeat SRI goals if SRI became acceptable under silent instruments.

21. It may be time to unbundle SRI and seek a laxer standard for foundations and charities than for pension and private trusts.¹³⁰

22. Push the ideas of nonfinancial trust income (i.e., of psychic income,¹³¹ of social return, of nonpecuniary return); of implied setting aside by the grantor of the fiduciary duties that forbid SRI; of the usefulness of the argument that a majority of the beneficiaries can set aside the duties that forbid SRI which morphs into the argument that virtual representation can be used to tie the hands of minor and

¹³⁰ It could be argued that the business judgment rule means that the lowest SRI standard is applied to the profit seeking investments of for profit corporations. There is no cause of action for not making tennis balls. As to a change in nonprofit endowment investing see Peter D. Kinder, *New Fiduciary Duties in a Changing Social Environment*, *Journal Investing*, Fall 2005, at 24; Peter D. Kinder, “Socially Responsible Investing”: An Evolving Concept in a Changing World (2005), <http://www.kld.com/resources/papers/SRIevolving050901.pdf>; Mark Kramer & Sarah Cooch, *Investing for Impact: Managing and Measuring Proactive Social Investments* (2006); Mark R. Kramer, *Foundation Trustees Need a New Investment Approach*, *Chron. Philanthropy*, Mar. 26, 2006. For discussion of the idea that nonprofits are different than for profits in another context see Linda Sugin, *Resisting the Corporatization of Nonprofit Governance: Transforming Obedience into Fidelity*, 76 *Fordham L. Rev.* (forthcoming 2007).

¹³¹ I think the idea of psychic income is captured in the expressions “utility function beyond return and risk.” Mark Kritzman, *The Portable Financial Analyst* 78-79 (2d ed. 2003) (discussing utility function). It also can called noneconomic factors in investing. Its first cousin is Langbein’s “other impacts” when he referred to Harvard letting Jack Meyer leave Harvard to shut up the whiners. The screening out of stocks that offend is called by some aversion investing. This catches the psychic part of psychic income to my satisfaction.

My research assistant in the Summer of 2007, Nicholas Godlove, UCD Class of 2009, has taken a shine to the idea of an Islamic SRI fund. He proposes a fund with low volatility and high return. Let us take that to be the case. What if the trustee of a private trust for religious Jewish beneficiaries buys this fund? Can they successfully claim that the psychic pain requires a court to order the recalcitrant trustee to sell the fund? To pay damages? Is it proper to use this fund as a benchmark when trustees are successfully sued by beneficiaries who are discontent with their trust’s return?

My colleague Chris Elmendorf suggests that a university or a charity may have no duty to create a bandwagon but may have a duty to get on one that impacts their mission or their effectiveness. There is a duty to pick your battles.

unborn beneficiaries who might complain at a future date about SRI investing.¹³²

a. Let's talk about psychic income.¹³³ It seems to me that if SRI proponents can get recognition for psychic income they have achieved a major victory. There are three currencies, I would submit: time, money and happiness.¹³⁴ The only one recognized in the trust world, historically, is money. Thus I assume that the default rule is that the trustee is to invest without regard to the mental well being of the beneficiary(ies) if the trust is silent.

So my thought for SRI folks is try to get some recognition for happiness, for psychic income for the beneficiaries.

Psychic income can be negative or positive. Let's go negative first. Assume an Islamic SRI fund¹³⁵ with low volatility and high return. What if, without animus, the trustee of a private trust for beneficiaries who happen to be Jews who are offended by the investment buys this fund? Can the beneficiaries successfully claim that the psychic pain this investment causes them requires a court to order a recalcitrant trustee to sell the fund? To pay damages? Is there a difference between claimed mental pain and claimed physical illness? Will a

¹³² Assuming that psychic income is given credence what do we do about the doctrine of virtual representation? I want the psychic income of SRI. Does that bind my son who is my successor in interest? His child (unborn)? Can a guardian ad litem appointed to represent the incompetent or the unborn do anything but fight psychic income for her wards? Especially if the ward is incapable, by virtue of limits of mind, of 'spending' the psychic income. A conservative statute dealing with virtual representation is N.Y. EPTL 7-1.9. Cf. statutes dealing with "decanting" the trust into a new trust that has new terms that in some circumstances allow for action without beneficiary approval. E.g., NY EPTL 10-6.6(b). There are also such statutes at Delaware (12 Section 3528), South Dakota (2007 Session Laws HB 1288), Alaska (13.36.157) and Tennessee (816(b)(27)).

¹³³ One can argue that psychic incomes ideas lurk in the SRI concept of the "triple bottom line." See Julie Hudson, *The Social Responsibility of the Investment Profession* (a research foundation of [the] CFA Institute monograph). www.cfopubs.org. 83, 85 (2007) ("The triple bottom line accounts not just for the economic bottom line but also for social externalities and stakeholder issues.")

¹³⁴ The economics of happiness has taken off as a topic worthy of academic concern in recent years. See, e.g., Luigino Bruni & Pier Luigi Porta, *Handbook on the Economics of Happiness* (2007).

¹³⁵ I suppose it's really an RRI fund (religiously responsible investing). See *Mutual Interest: When Hedge Funds Meet Islamic Finance*, Wall St. J., August 9, 2007, at A1.

doctor's certificate make the difference?¹³⁶ The law's experience with tort damages for mental anguish suggest it will be an uphill climb.¹³⁷

Let's talk about positive psychic income.¹³⁸ Here's one that could be either negative or positive. If the trust income beneficiary is a public figure who is being pilloried for being the beneficiary of a trust that invests in "Sudanese" securities can the trustee divest and not breach his fiduciary duties? I assume the answer is "yes" if our public figure is the only beneficiary and I assume we are talking about some kind of psychic income.¹³⁹ Turn it around. What if the beneficiary can obtain public esteem by being the beneficiary of a trust that is being run "wisely" in accordance with SRI principles?¹⁴⁰ Again, I assume the answer is yes (SRI is OK), if he is the only beneficiary. Indeed, the beneficiary can always set aside the duty to earn more money for the income account. But what if the divestment increases the (calculated) risk to the portfolio, or reduces the return? That affects the remainder, too.

I assume that if a grantor required the trustee to take income beneficiary Aunt Dorothy's mental sense of well being into account in making trust investments that a court would enforce that as long as it wasn't waste.¹⁴¹ If a 100% equity portfolio concerned Aunt Dot quite

¹³⁶ Would it be proper to use this fund as a benchmark when trustees are successfully sued by Jewish beneficiaries who are discontent with their trust's return?

¹³⁷ See Albert Lin, *The Unifying Role of Harm in Environmental Law*, 2006 *Wis. L. Rev.* 897 (2006)

¹³⁸ Thomas W. Joo discusses the analogous issue of shareholders' nonpecuniary interests in Thomas W. Joo, *The Modern Corporation and Campaign Finance: Incorporating Corporate Governance Analysis into First Amendment Jurisprudence* 79 *Wash. U. L. Q.* 61-62 (2001).

¹³⁹ Cf. Christopher Cooper, *Edwards, Foreclosure Critic, Has Investing Tie to Subprime Lenders*, *Wall St. J.* August 17, 2007, A1 (Investigative reporter discovers John Edwards invests in a hedge fund that is foreclosing on poor people in New Orleans); Matthew Yi, *Global Warming Watchdog Invests in Oil, Coal, Utilities*, *San Francisco Chron.* 1 (August 18, 2007) (California Air Resources Board chair on the first page, scolded for her investments).

¹⁴⁰ What about the net positive social effect of numerous trusts acting as sin eaters or professional mourners by engaging in SRI investing?

¹⁴¹ The ultimate article about waste is Lior Jacob Strahilevitz, *The Right to Destroy*, 114 *Yale L.J.* 781 (2005). It is tempting to wonder if the income beneficiary's ability to forgo income in the name of SRI (if there is no harm done to principal beneficiaries) is best understood as waste by an owner (of the income interest). It is also tempting to wonder if a spendthrift provision precludes such a blessing of SRI by an income beneficiary. Cite the case in the casebook re treasury obligations and poppa not wanting any risk taken.

Can the trustee conceal aspects of the trust's investment policy for wholesome psychic purposes? Its investment policy? (Sudan; or taking more risk than Aunt Dorothy might like). Aunt Dorothy can't be worried about what she doesn't know about.

meaningfully then my hypothetical trustee ought to be able to add enough bonds to let her sleep at night even if there was money to be gotten for taking more risk. In the hypo the grantor specifically allowed for some laziness of trust money, which is arguably all that the negative review of SRI is about – lazy money for a good reason. If the trust was silent and Aunt Dorothy was miserable because the trust was 100% in equity many readers would see the trustee as a jerk for not getting some bonds so Aunt Dorothy could get a good night's sleep and a court might even remove the trustee for lack of compatibility with the beneficiary, but I wouldn't expect a court to say, at this time, that the trust income beneficiary is entitled to psychic income as well as pecuniary income.

b. So, let's talk about implied setting aside of the general rule that SRI is only proper in a silent trust when the return and the risk are the same as an unconstrained portfolio. Everyone has always assumed that the silent trust requires an unconstrained portfolio, or its equivalent. At one time this meant getting the same return. Now it seems the return and the risk must be the same. SRI folks might hope to change the default rule – to put us in a world where a silent trust can be invested in an SRI portfolio.¹⁴² Or, they might hope for a world where an equivalent return, without regard to risk, is what a silent trust allows/requires.

If the default rule remains unchanged, then the question becomes: when do the circumstances allow a court (or a lawyer rendering an opinion, or a trustee taking a chance) to conclude that the duty to get an appropriate full return has been impliedly set aside. When does the situation suggest that the grantor would have wanted such a set aside? When is economic gain outweighed by other impacts?¹⁴³ When is there a utility function beyond return and risk that was taken into account by the grantor and that should be taken into account in determining the propriety of the trustee's investment policy?¹⁴⁴

¹⁴² Ignore the pipe dream of a default rule that all silent trusts must be invested in an SRI portfolio unless the grantor otherwise provides. Neither idea is mine. I have forgotten who put the "change the default rule" forward. Apologies.

¹⁴³ Milton Friedman's hippy grandchildren might have trouble arguing grantor's intent. I thank Tom Joo for the point.

¹⁴⁴ Mark Kritzman, *The Portable Financial Analyst* 78-79 (2d ed. 2003) (discussing utility function).

Here is a hypothetical illustration: "I am the beloved widow. Widows always win. The risks you are taking are killing me. My late husband Joe would have written into the trust a direction not to make me miserable if he'd thought of it. So that is his undeclared intent. Now honor it." Or, "my late wife devoted her life to saving the environment and this bank's investing in polluters besmirches her memory. The guardian of our unborn grandchildren's remainders refusal to agree to divestment is a disgrace. Please read this trust as containing an implied setting aside of the duty to hold an unconstrained portfolio."¹⁴⁵

c. Let's talk about virtual representation.¹⁴⁶ Virtual representation exists when a jurisdiction, by common law or statute, allows a particular beneficiary to virtually represent other beneficiaries so that the other beneficiaries (perhaps unborn) need not be represented by a guardian ad litem. If the current income beneficiary wants an SRI portfolio s/he can immunize the trustee against her suing for a lower return, but she cannot bind her successors in a silent trust absent a determination that she virtually represents them—that her interests are the same as theirs and her self-interested agreement to trustee conduct protects her virtual wards. To the extent that virtual representation doctrine is expanded the opportunities exist for current pro-SRI trust beneficiaries to bind future beneficiaries. The problem is that if the SRI beneficiary is embracing SRI for non-pecuniary reasons then it is hard to say there is virtual representation. It's different if you are the next income beneficiary. My agreement to an investment may well protect your financial interests. But, I can't fall in love for you and I can't approve SRI for you for non-pecuniary reasons either, is the thought. But if a legislature or a common law judge says I can, well then maybe I can.

¹⁴⁵ Nonpecuniary aspects of pecuniary interests is discussed extensively in Evelyn A. Lewis, *Struggling with Quicksand: The Ins and Outs of Co-tenant Possession Value Liability and a Call for Default Rule Reform*, 2 *Wisconsin L. Rev.* 331 (1994); Reprinted in *A Property Anthology*, Second Edition, 234 (R. Chused ed., 1997). If an income beneficiary is dependent on a trust then the smoothness of the income is very important. If the income beneficiary is elderly and a worrier and so dependent the smoothness becomes all the more important. I would propose there is a psychic income element to this. One might sacrifice return for smoothness without any specific authorization in the trust or in local law.

¹⁴⁶ The Restatement deals with virtual representation in section 65, Reporter's Note on comments b and c and the Uniform Trust Code deals with it in section 304. See Restatement (Third) of Trusts 65 Reporter's Notes, cmts. b & c (2003); Unif. Trust Code 304 (2005).

Thus SRI folks might seek to convince a legislature to extend the local virtual representation regime to allow some trust beneficiaries to approve SRI for all. Or a defendant trustee might successfully make the claim.

An intriguing sub-version of this might be if a private trust was converted from a traditional “Income to A, remainder to B” trust into a unitrust and if the “income” beneficiary then allowed the trustee to engage in SRI investing. Would the income beneficiary virtually represent the remainder beneficiary? There are arguments that she would. They go as follows. The whole point of a unitrust is to “put income and remainder beneficiaries on the same page,” to end the conflict of interest and to make them both interested in the same thing – the total return/growth of the overall trust portfolio. They are “partners” in the same venture with the income beneficiary being the junior partner. Indeed, in a long term unitrust, when you do an actuarial calculation, their interests may be closer than first appear when one calculates the present discounted value of the remainder interest. I would be pretty open to the argument that many unitrust income beneficiaries can wisely be said to virtually represent the remainder when purely pecuniary issues are involved. Query, though when the issue is SRI, because the psychic income for the unitrust “income” beneficiary may not pay off for the remainder beneficiary.

23. Seek to have SR concerns added to the lists of nonfinancial measures of performance that determine the compensation of senior executives of major corporations. Such measures are becoming ever more common and it is at least theoretically possible that SR concerns can be added to compensation schemes.¹⁴⁷

24. Seek the design of an SRI investment that “magically” reduces income but not principal. Then if the trust says income to A for life, remainder to B and if A is content to forswear income for social responsibility, B’s OK is not required. Easier said than done.

¹⁴⁷ Stefan Stern On Management; Hidden ingredients of a better board performance, Fin. Times 12, Aug. 14, 2007.

25. Seek to encourage the creation of a complete SRI bibliography by an academic librarian. It would make research easier and I believe the thickness of the book and the count of pro-SRI articles would move SRI forward.

26. Reach out to the quants. Somehow, obtain the conversion of a high visibility quant to SRI. It should have no positive effect but it might well.

Figure out a way to reach the decent quants who run a lot of money. By decent quants I mean folks who stay with their first spouse, give a lot to charity, value education, invest in their children, belong to their equivalent of the Rotary club, yada yada. They cannot be reached by missionary zeal, twisting their vocabulary or attacking their religion (MPT).

CONCLUSION

SRI has come a long way since the 1980s. There are several SRI cases to make in different courts. The quantitative case for SRI is less dismissible than it once was. There are gaps in the case. Accept it. One gap filler is the idea that increased risk for the good of society can be justified. Risk for a reason is not unwholesome in today's world.